Audit Report

OFFICE OF THE INSPECTOR GENERAL

ARMED FORCES RECREATION CENTER-ORLANDO

Report No. 95-308 September 21, 1995

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Department of Defense

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Acronyms

AFRC	Armed Forces Recreation Center
ABIF	Army Banking and Investment Fund
AMWRF	Army Morale, Welfare, and Recreation Fund
CFSC	U.S. Army Community and Family Support Center
HCMF	Hospitality Cash Management Fund
MWR	Morale, Welfare, and Recreation
NAFI	Nonappropriated Fund Instrumentality

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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September 21, 1995

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (PERSONNEL AND READINESS)
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Followup Audit Report on Armed Forces Recreation Center-Orlando (Report No. 95-308)

We are providing this audit report for review and comment. We conducted this audit in response to a request by the Office of the Under Secretary of Defense (Personnel and Readiness) that we follow up on Inspector General, DoD, Report No. 95-087, "Armed Forces Recreation Center-Orlando," January 27, 1995. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. The Under Secretary of Defense (Personnel and Readiness) did not comment on Recommendations A.1. and B.1. The Army nonconcurred with Recommendation A.2., and its proposed actions in response to Recommendations B.2., C.1., and C.2. were not acceptable. We request that the Under Secretary of Defense (Personnel and Readiness) and the Army provide comments on the unresolved recommendations by November 20, 1995.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Robert J. Ryan, Audit Program Director, at (703) 604-9418 (DSN 664-9418) or Mr. Joseph A. Powell, Acting Audit Project Manager, at (703) 604-9415 (DSN 664-9415). See Appendix U for the report distribution. The audit team members are listed on the inside back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

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Office of the Inspector General, DoD

Report No. 95-308 **September 21, 1995**
(Project Number 5LA-5040)

Armed Forces Recreation Center-Orlando

Executive Summary

Introduction. The U.S. Army Community and Family Support Center manages the morale, welfare, and recreation program for the Army, and established the Armed Forces Recreation Center in Orlando, Florida (AFRC-Orlando). The Army standards state that for activities such as AFRC-Orlando, net income before depreciation should be break even or positive. During the initial approval process in 1993, the Acting Secretary of the Army stated that the AFRC-Orlando had to be completely self-sustaining. As a result of the escalating rental costs of the lease, the Community and Family Support Center planned to purchase the hotel and prepay the land rent at a cost of over $ * .

Audit Objectives. The primary objective was to validate the financial and operational projections for AFRC-Orlando.

Audit Results. The Community and Family Support Center did not effectively analyze and evaluate the cost to purchase AFRC-Orlando, which was over $ * higher than if hotel services were procured from commercially available sources at preferred rates through a central reservation system (Finding A). Other factors weighing against purchasing AFRC-Orlando follow.

o For 68 percent of AFRC-Orlando patrons, it is better if AFRC-Orlando is full when they call for a reservation because they will receive a less expensive hotel accommodation (overflow or commercial rate) at another Disney hotel. The remaining 32 percent of patrons will receive the same room rate at another Disney hotel if AFRC-Orlando is full.

o Only about 1 percent (14,316) of active duty military personnel use AFRC-Orlando in a year.

o Nonappropriated funds are used to subsidize 37 percent of the present occupancy of AFRC-Orlando by retired military, DoD civilians, and golfers.

The AFRC-Orlando was not financially self-sustaining. The Army and consultant financial forecasts did not follow generally accepted accounting principles. Unless room rates are increased, other AFRCs or nonappropriated fund organizations will be required to fund a $27.2 million subsidy of AFRC-Orlando. Using other AFRC funds to subsidize the purchase and maintenance of AFRC-Orlando represents an indirect use of appropriated funds, because overseas AFRCs received $55 million of appropriated

*Proprietary data deleted.

funds from FY 1991 through FY 1995 and the subsidies will continue. Further, all military personnel will be subsidizing AFRC-Orlando with $20.5 million in unearned interest (Finding B).

The AFRC-Orlando did not program for long-term maintenance liabilities to maintain all aspects of the hotel to Disney standards. As a result, AFRC-Orlando was projected to need an additional $44 million in the Furnishing Reserve fund in FY 2020 to pay for major renovation costs (Finding C).

Potential benefits to Service members can be realized if the lease is terminated before termination costs apply. Use of central reservations and hotel discounts will result in reduced room rates for all Service members visiting Orlando and in funds being made available for other military morale, welfare, and recreation activities.

Summary of Recommendations. We recommend that the purchase of AFRC-Orlando not be approved, that alternative projections be used in the approval decision, that the hotel lease be terminated, and hotel discounts be negotiated for a central reservation system. We also recommend that the Army revise its projections of the results of operations and cash flow of AFRC-Orlando to more accurately reflect expenses, income, and cash set aside under terms of the lease. If the Army purchases the building and prepays the land rent, we recommend that the Army raise room rates in FY 1997, develop a maintenance plan, and plan to finance the maintenance by using AFRC-Orlando generated cash flow.

Management Comments. The Under Secretary of Defense (Personnel and Readiness) did not comment on the draft report. The Army nonconcurred with establishing a central reservation system and with terminating the lease agreement. It stated that a central reservation system would not have sufficient demand from Service members and the system would lose money. The Army stated that its financial projections were correct. Further, the Army stated that hired consultants validated its conclusions to purchase AFRC-Orlando. The Army also stated that the amount of room rate increase could be determined only after it evaluates FY 1996 operating results. The Army agreed to establish a plan for the phased renovation of AFRC-Orlando, and stated that it will generate adequate funds to support those renovations. See Part I for a summary of management comments on the recommendations, Part II for a summary of management comments on the findings, and Part III for the complete text of management comments.

Audit Response. A central reservation system would be the best use of the soldiers' money and would provide an improvement in the Service members quality of life with the minimum possible investment and long-term liability. On the other hand, not terminating the agreement requires a major investment and assumption of significant long-term liabilities. The financial projections that the Army used were incomplete. The consultants either were not provided all data available to us, or were not asked to perform some analysis (Appendix F and Appendix K). The consultants verified our estimated long-term maintenance costs but the Army showed the costs regressed to FY 1995 dollars not projected forward. The Army also was not recognizing the financial resources needed to fund the phased major renovation of AFRC-Orlando. We ask the Under Secretary of Defense (Personnel and Readiness) and the Army to provide comments in response to the final report by November 20, 1995.

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Part I - Audit Results

Audit Background

On January 27, 1995, we issued Inspector General, DoD, Report No. 95-087, "Armed Forces Recreation Center-Orlando." This audit was performed in response to a request from the Under Secretary of Defense (Personnel and Readiness) to follow up on financial issues included in Report No. 95-087. The audit request also asked us to revalidate the financial and operational projections for Armed Forces Recreation Center-Orlando (AFRC-Orlando) prepared by the U.S. Army Community and Family Support Center (CFSC).

The CFSC is responsible for morale, welfare, and recreation (MWR) programs for the Army. On November 3, 1993, the Army Morale, Welfare, and Recreation Fund (AMWRF), operated by CFSC, contracted with the Palm Hospitality Company (a Disney subsidiary) to lease a 20-acre hotel property on the Walt Disney World Resort in Orlando, Florida (hereinafter referred to as Disney) to establish AFRC-Orlando. The Army was seeking a means of providing accommodations and recreation to DoD military and civilian personnel and their families within the continental United States. The lease agreement between the Army and the Palm Hospitality Company spans 100 years. The lease requires the Army to manage and maintain the hotel and its facilities to Disney standards for the duration of the lease. The leased hotel consists of 287 guest rooms, 2 restaurants with lounges, 2 swimming pools, a physical fitness room, and a ticket office for local attractions. The hotel was officially named Shades of Green on Walt Disney World Resort and opened on February 1, 1994.

As a result of financial concerns addressed in Inspector General, DoD, Report No. 95-087, CFSC is pursuing an option to purchase the hotel from Disney and prepay the land rent. The CFSC must obtain the approval of the Under Secretary of Defense (Personnel and Readiness) to exercise the purchase agreement. The cost of purchasing the hotel and prepaying land rent is $ * , which would be paid in two equal installments of $ * on September 28 of 1995 and 1996. The purchase price of the building and contents at AFRC-Orlando was $ * , and the prepayment of the land rent was $ * . The AMWRF will advance CFSC $ * for the purchase of AFRC-Orlando, and the CFSC Hospitality Cash Management Fund (HCMF) will provide the other $ * . The HCMF working capital consists of funds contributed by the AFRCs located in Europe, Korea, and Hawaii (Appendix J). If a decision is made to terminate the lease, CFSC should terminate the lease for AFRC-Orlando by November 2, 1996, to avoid termination costs of $ * .

*Proprietary data deleted.

Audit Objectives

The primary audit objective was to validate the financial and operational projections for AFRC-Orlando. Specifically, we evaluated the actual and forecasted financial statements of the AFRC-Orlando to determine whether MWR standards of financial performance were met, and to determine whether the terms of the lease agreement were fair and reasonable. We also reviewed the adequacy of the management control program and the performance indicators applicable to the audit objectives. See Appendix A for a discussion of the audit scope and methodology and for the results of the review of the management control program. See Appendix B for a summary of prior coverage related to the audit objectives.

Finding A. Alternative to the Acquisition and Operation of Armed Forces Recreation Center-Orlando

The CFSC did not effectively analyze and evaluate a possible alternative to the acquisition and operation of AFRC-Orlando. This occurred because CFSC did not adequately consider the operation of a central reservation system as a less costly alternative that would allow terminating the lease for AFRC-Orlando. As a result, the additional cost of over $ * and the business risks involved in acquiring AFRC-Orlando were higher than if hotel services were procured from commercially available sources for preferred rates through a central reservation system. In addition, financial projections (Finding B) show that AFRC-Orlando operations costs of $27.2 million and long-term maintenance requirements (Finding C) of $44 million will need to be subsidized by the other Army Nonappropriated Fund activities.

DoD Policy on Recreational Activities and Services

DoD Directive 4100.15, "Commercial Activities Program," March 10, 1989, provides policy that DoD activities should minimize duplication of services available from the private sector. DoD Instruction 4100.33, "Commercial Activities Program Procedures," September 9, 1985, provides for DoD Components to rely on commercially available sources to provide commercial products and services, except when required for national defense.

DoD Directive 1015.6, "Funding of Morale, Welfare, and Recreation Programs," August 3, 1984, provides policy stating that DoD Components shall ensure that the life-cycle cost of MWR facilities to be financed from appropriated or nonappropriated funds is held to a minimum; and type and size are the most economical and efficient obtainable. The directive also requires the Secretary of Defense to approve purchase of MWR facilities located on private land.

The AFRC-Orlando is a DoD commercial activity providing recreational hotel services to Armed Forces members and retirees and to DoD civilians in a secure family environment. It is the first AFRC in the continental United States. The AFRC-Orlando was established due to decreasing deployments outside the continental United States, a largely married military force, and the need to serve the total force including active duty, Reserves, National Guard, DoD civilians,

*Proprietary data deleted.

and their families. In the past, CFSC has operated AFRCs exclusively outside the continental United States to provide commercial quality vacations beyond the financial capability of many service members.

In response to our request, CFSC provided us a memorandum (Appendix D) detailing reasons for not contracting for the operation of the hotel and recreational travel services provided by the AFRC-Orlando. The CFSC plan to continue to operate the hotel and to purchase the building and prepay the land rent is subject to the approval of the Secretary of Defense and the Under Secretary of Defense (Personnel and Readiness).

Use of Central Reservation System

The CFSC did not effectively analyze and evaluate all other possible alternatives to the acquisition and operation of AFRC-Orlando such as the operation of a central reservation system. The CFSC had not followed DoD procedures to rely on commercially available sources and not duplicate services available from the private sector. Negotiating lower rates for rooms and attraction tickets with participating hotels with amenities, services, and in locations comparable to the Shades of Green would be an alternative method of providing the services and would not require a $ * investment of MWR funds. Additionally, no long-term financial and maintenance liabilities would ensue. While the cost would be greatly reduced, CFSC could still achieve the DoD MWR mission to improve the quality of life for service members.

Central reservation systems have been effectively used by the Army for commercial hotel lodgings in Washington, D.C. The Army has successfully negotiated hotel rate discounts of about 30 percent based on the volume of service member business. Additionally, the Army Billeting Fund operates the Army Central Reservation Center in Huntsville, Alabama, for managing Army transient facilities. Reservations are booked for 129 transient facilities and hotels in the continental United States.

A central reservation system already exists at AFRC-Orlando. The reservation office is located in structures erected by CFSC behind Shades of Green. The reservation system effectively handles bookings for the hotel and local attractions. The AFRC-Orlando earns a 10-percent commission on overflow referrals when the room rental is paid. It also earns commissions on airfare and travel bookings. The AFRC-Orlando central reservation system, for example, earned commissions of $31,775 in February 1995 and had expenses of $19,892, leaving a profit of $11,883 in one month. With an established booking of 275 rooms per night (100,565 rooms a year), we believe that CFSC can negotiate with Palm Hospitality Company and other Orlando area hotels

*Proprietary data deleted.

for significant discounts of about 30 percent. In a 1-year period, the AFRC-Orlando reservation office booked 143,372 room-night reservations for rooms at Shades of Green and other Disney and non-Disney hotels in Orlando. This would provide a quality of life service for the Service members, provide income for the AMWRF, and avoid the financial and maintenance liabilities of operating the Shades of Green. If the reservation office is told to relocate due to termination of the lease, it could be reestablished on a Government installation at a cost of about $0.5 million.

Cost Comparison of an Alternative to Buying AFRC-Orlando

We compared AFRC-Orlando present room rates and FY 1997 projected room rates with existing overflow rates and rates that could be negotiated. Comparison of room rates shows that significant savings to the service member are available through use of a central reservation system.

Table 1 compares the AFRC-Orlando room rate by category with an alternate hotel room rate. Table 1 also shows that for all rate categories, a commercial alternative is equivalent or more economical than AFRC-Orlando. Disney's All-Star Resort has 3,840 rooms, swimming pools, food courts, transportation to Disney attractions, guest laundry services, and access to all other Disney services.

Table 1. Comparison of 1995 Orlando Daily Hotel Rates by Rate Category

Rate Category[1]	Percent Usage	AFRC Rate	Overflow Rate[2]	Alternate Hotel
I	32	$49	$ *	Disney's All-Star Resort
II	34	73	*	Disney's All-Star Resort
III	30	85	*	Disney's All-Star Resort
IV	4	92	*	Disney's All-Star Resort

[1]I = Private through Sergeant, or Service equivalent.
II = Staff Sergeant through Command Sergeant Major, 2nd Lieutenant through Captain, Warrant Officer 1 through Chief Warrant Officer 3, or Service equivalent, GS1 through GS10.
III = Chief Warrant Officer 4 through Chief Warrant Officer 5, Major through Colonel, or Service equivalent, GS11 through GS15.
IV = Brigadier General through General, or Service equivalent, Senior Executive Service.

[2]Although the overflow rate at Disney's All-Star Resort is $ * , its commercial rate is $69.

We noted that 68 percent of AFRC-Orlando patrons (categories II, III, and IV) could find less expensive hotel accommodations on Disney property through overflow bookings, and the other 32 percent (Category I) could find equal rates. Table 2 shows that all AFRC-Orlando patrons will be able to find less expensive hotel accommodations outside Shades of Green in FY 1997 if all room rates are adjusted for inflation and a needed $14 room rate increase (discussed in Finding B) is implemented to make Shades of Green self-sustaining.

*Proprietary data deleted.

Table 2. Comparison of AFRC-Orlando FY 1997 Daily Room Rates with Commercial Room Rate

Category	FY 1997 Room Rate[1]	Overflow Rate[2]	Commercial Rate[3]
I	$ 71	$71	$58
II	96	71	58
III	107	71	58
IV	113	71	58

[1]The FY 1997 room rate is based on the FY 1996 rate escalated by 4 percent for inflation, plus a recommended increase of $14.

[2]AFRC-Orlando personnel informed us that overflow rates at the All-Star Resort are intentionally negotiated to rates close to the category I rates at AFRC-Orlando.

[3]The commercial rate at Disney's All-Star Resort of $69 was escalated at 4 percent per year from 1995 to 1997, then decreased by an estimated discount of 30 percent. The commercial rate was increased by 11 percent for room taxes.

Other Orlando area hotels offer rates lower than AFRC-Orlando. For example, one hotel a mile from Disney World offers a rate of $47 per night including a free breakfast. Escalating the price at 4 percent for 2 years for inflation and 11 percent for room taxes yields a comparable rate of only $56 per night.

Benefits, Costs, and Business Risks

The benefits provided by purchasing the Shades of Green do not justify the differences between the cost of establishing and operating a central reservation system and the cost and business risks of investing in and maintaining a hotel. The CFSC will have to pay $ * to purchase the building and prepay the land rent on Shades of Green. The CFSC agreement with Palm Hospitality Company requires CFSC to maintain Shades of Green to Disney standards for 100 years. The CFSC would therefore accept significant maintenance liabilities in the agreement with Palm Hospitality Company to lease Shades of Green and significant business risks associated with a resort hotel at a theme park (Appendix E). However, if CFSC uses the established central reservation system or establishes the system at a new site, an investment of only

*Proprietary data deleted.

$0.5 million or less for reservation equipment and facilities would be needed. By negotiating room rates with Orlando area hotels and operating a central reservation system, CFSC can avoid expending $ * to acquire the hotel and the added costs for long-term maintenance. By so doing it could still provide comparable benefits to service members and DoD civilians. The CFSC contracted with a consultant, Pannell Kerr Forster Consulting, Inc. (PKF Consulting), to estimate the results of operating a telephone reservation system. Appendix F compares our estimates with the PKF Consulting study.

Management Comments on the Finding and Audit Response

The Army commented extensively on the finding. See Appendix R for a summary of the Army's comments and audit response.

Recommendations, Management Comments, and Audit Response

A.1. We recommend that the Under Secretary of Defense (Personnel and Readiness) not approve the purchase of the Armed Forces Recreation Center-Orlando and direct the U.S. Army Community and Family Support Center to use its central reservation system for booking of service members in the Orlando area.

Under Secretary of Defense Comments. The Under Secretary did not comment on the draft report.

Army Comments. The Army, although not required to comment, did not agree with the recommendation. It recommended that the Office of the Secretary of Defense approve the purchase. The complete text of management comments is in Part III.

Audit Response. The Army comments are not required. Only the Office of the Under Secretary can approve the purchase.

We request comments from the Under Secretary of Defense in response to the final report.

*Proprietary data deleted.

A.2. We recommend that the Commander, U.S. Army Community and Family Support Center:

a. Negotiate hotel discounts and use the established central reservation system or relocate the system to a new site instead of exercising the option to purchase the hotel and prepay the land rent at Armed Forces Recreation Center-Orlando.

Army Comments. The Army nonconcurred, and stated that a central reservation system would be disadvantageous to the soldier because increasing prices fail to equal the perceived benefit and the system would lose money indefinitely. The Army also stated that there is insufficient demand for and insufficient advantage to support that type of MWR service. The Army further stated that the recommendation fails to recognize the DoD mission to improve quality of life of Service members. Additionally, it stated that the recommendation does not recognize the benefits of providing a premium resort at an affordable price.

Audit Response. The Army comments were not responsive. The operation of a central reservation system would mitigate the investment cost, business risks, and liabilities of maintaining a hotel while offering affordable vacation opportunities in the Orlando area to Service members and their families. The Army Central Reservation Center and Lodging Success Program negotiated 30 percent discounts on commercial hotels. Due to the purchase and operation costs of AFRC-Orlando, required room rates will be so high after the initial purchase period is passed that AFRC-Orlando will penalize Service members. The Army did not address the fact that 68 percent of the current users of AFRC-Orlando can get a better room rate by calling a Disney hotel. Therefore, the alternative central reservation system would be more economical for most Service members.

The Army conclusion that closing AFRC-Orlando would lead to a loss of customers is based on a nonstatistical sample using questions that biased the results. The sample results did not support a conclusion that 50 percent of the patrons would not have come to Orlando were it not for AFRC-Orlando. Our estimates show that the central reservation system would make a profit. We request that the Army reconsider its position and provide additional comments in response to the final report.

b. Terminate the lease for the Armed Forces Recreation Center-Orlando.

Army Comments. The Army nonconcurred, and stated that it plans to continue the approval process for purchasing Shades of Green and prepaying land rent.

Audit Response. We disagree with the Army's intent to pursue purchasing Shades of Green and prepaying the land rent. Our analysis of the Army's nonstatistical patron survey showed that only 20 percent of the respondents said they would not have vacationed in Orlando were it not for Shades of Green. The benefits offered by Shades of Green are offered to all users of hotels located on Walt Disney World Resort. The Army could avoid expending $ * of the Service members money, avoid the risks associated with operating and maintaining a hotel, and provide lower cost hotel rooms than the Shades of Green to another 68 percent of the current patrons. The Army can improve the quality of life for Service members by operating a central reservation system to provide affordable vacations in Orlando. We request that the Army reconsider its position and provide additional comments in response to the final report.

*Proprietary data deleted.

Finding B. Financial Projections for Armed Forces Recreation Center-Orlando

The AFRC-Orlando was not financially self-sustaining. CFSC had established Shades of Green room rates at financially unsupportable levels with projected results of operations and cash flow that were inaccurate and not in accordance with generally accepted accounting principles. As a result, CFSC will need to either initially increase room rates about * percent ($ *) for all patrons or divert from other Army nonappropriated fund instrumentalities (NAFIs) the additional cash funds ($27.2 million) required to sustain operations and meet obligations of AFRC-Orlando. Furthermore, the Service members will be subsidizing AFRC-Orlando with $ * in unearned interest for the Army nonappropriated funds.

Approval to Open AFRC-Orlando

The Deputy Secretary of Defense approved the lease of AFRC-Orlando on October 29, 1993. The then Acting Secretary of the Army approved AFRC-Orlando based on the expectation that it would achieve self-sufficiency. Army Regulation 215-1, "The Administration of Army Morale, Welfare, and Recreation Activities and Nonappropriated Fund Instrumentalities," October 10, 1990, states that financial management of NAFIs is based on three principles. One of those principles is that each NAFI is required to be self-sustaining. Self-sustaining is defined as the generation of a positive net income sufficient to provide for operational requirements and for all programmed nonappropriated fund capital expenditures not funded by the AMWRF.

Financial Projections for AFRC-Orlando

The AFRC-Orlando was not financially self-sustaining at current room rates. Based on actual financial operations from June 1994 through May 1995, we estimated the net income and cash flows that would result from AFRC-Orlando operations. The cash flow derived from revenues is projected to be insufficient to sustain operations and meet obligations of AFRC-Orlando.

*Proprietary data deleted.

Cash Flow. While the projected cash flow is sufficient to sustain short-term hotel operations, it is insufficient to sustain long term hotel operations and meet obligations of AFRC-Orlando. We estimated the cash flow for each year from FY 1996 through FY 2020 based on current room rates as adjusted for inflation (Appendix G). If room rates are only increased for inflation, estimated at 4 percent per year, cash flow will range from a low of $0.6 million in FY 1997 to a high of $2.4 million in FY 2020. This positive cash flow seems to indicate that hotel operations can be sustained; however, as discussed below, this level of cash flow is only sufficient for short-term hotel operations and does not provide the cash needed for other financial obligations.

Cash Flow and Loan Payment. The estimated cash flows for FY 1996 through FY 2010 will not be sufficient to pay the $ * loan due to be repaid to AMWRF ($ * of the $ * purchase price is from other AFRCs) over a 14-year period beginning in FY 1997 for the purchase of the hotel and the prepayment of land rent. As shown in Appendix G, Table G-2, payment of the loan with the current room rates will result in negative cash flow. If room rates are not increased substantially in excess of inflation, we estimated that AFRC-Orlando will have a cash flow of $15.8 million through FY 2010, $ * less than the $ * AMWRF loan (Appendix H). If room rates are increased by $8 per night in FY 1997 in excess of inflation, AFRC-Orlando will have a cash flow of $29.4 million through FY 2010, $ * less than the AMWRF loan. If only the cash flow provided by AFRC-Orlando is to be used to pay the AMWRF loan, room rates need to be increased by $ * in excess of inflation in FY 1997. Appendix I graphically depicts the effects on cash flow of various room rates.

Cash Flows and Long-Term Maintenance. The current room rates at AFRC-Orlando do not support the estimated long-term maintenance requirements. We are assuming that cash flows for FY 1996 through FY 2010 will be used for loan payment and subsequent cash flows will be used for hotel renovation. The estimated cash flows from AFRC-Orlando for FY 2011 through FY 2020 will not equal the cost of renovating the hotel (Finding C). Hotel room rates must be raised by $ * in excess of inflation in FY 1997 if the cash flow provided by AFRC-Orlando is to be sufficient to support the long-term maintenance requirements.

CFSC Financial Projections for AFRC-Orlando

The CFSC financial projections did not follow generally accepted accounting principles and inaccurately projected net income and cash flow for

*Proprietary data deleted.

AFRC-Orlando. The CFSC overestimated the AFRC-Orlando income and did not include all the expenses and cash disbursements necessary to operate and meet its obligations.

Net Income. The CFSC estimated the net income at $2 million for FY 1996, while we estimated the net income at $0.22 million (Appendix G). The CFSC overestimated the FY 1996 net income by $0.4 million by overestimating both the expected occupancy rate (by 2 percent) and the average daily room rate charged (by $2). Additionally, CFSC did not include the depreciation expense of $1 million on the hotel buildings, the Capital Reinvestment Assessment of $0.4 million, or a $32,000 fee for audit by a public accounting firm. By overestimating income and ignoring those expenses, for FY 1996, CFSC overestimated net income by $1.8 million.

Cash Flow. The CFSC estimated the cash flow from AFRC-Orlando in FY 1996 to be $2.2 million, while we estimated the cash flow at $0.92 million (Appendix G). The CFSC did not consider that AFRC-Orlando was obligated by terms of the agreement with Palm Hospitality Company to put $0.5 million in an interest bearing bank account for maintenance. The CFSC also overestimated the AFRC-Orlando income before depreciation by $0.4 million and underestimated Capital Reinvestment Assessment expense by $0.4 million. As a result, CFSC overestimated the FY 1996 cash flow for AFRC-Orlando by $1.3 million.

Paying for AFRC-Orlando

AMWRF Loan. The CFSC plans to divert from other AFRCs the additional cash funds required to sustain operations and meet obligations of AFRC-Orlando. The cash flow from AFRC-Orlando is insufficient to pay AMWRF the $ * it advanced to CFSC to purchase AFRC-Orlando.

Because the cash flow from AFRC-Orlando is insufficient to pay the entire $ * AMWRF loan (Appendix G), CFSC expects the other AFRCs through HCMF to repay the difference. The three other AFRCs, listed in Appendix J, contribute funds to HCMF for its working capital. If room rates at AFRC-Orlando are not raised in excess of inflation, other AFRCs or NAFIs will be expected to provide AFRC-Orlando $ * toward the purchase price and $ * in loan payment. If room rates are raised in FY 1997 by $8 per night in excess of inflation, HCMF will still be required to pay $ * toward the purchase price, and $ * in loan payment. The CFSC expects patrons of the other AFRCs to subsidize AFRC-Orlando.

*Proprietary data deleted.

Subsidy from Other AFRCs and NAFIs. We believe it would be more appropriate to minimize the amount of the subsidy other AFRCs and NAFIs provide for AFRC-Orlando. Further, the net change in cash flow, according to the audited financial statements of the other AFRCs, from FY 1992 through FY 1994 would not provide the funds required to pay the loan from the AMWRF. The AMWRF loan is to be repaid over 14 years at a rate of $ * per year. However, the net change in cash flow from the other AFRCs decreased by $1.38 million in FY 1992, $0.26 million in FY 1993 and increased by $2.61 million in FY 1994, a net increase of $0.97 million in cash over 3 years (Appendix J). The net increase in cash from the other AFRCs in FY 1992, FY 1993, and FY 1994 was not enough to provide the needed subsidy. The cash flow for the other AFRCs does not recognize that $31 million of appropriated funds were provided in FYs 1992 through 1994 to make the AFRCs affordable for Service members. The CFSC contracted with Deloitte and Touche to evaluate whether the Army had sufficient funds to buy AFRC-Orlando. A comparison of the Deloitte and Touche study and our followup audit is in Appendix K. The Deloitte and Touche study stated that the Army could finance the purchase of the Shades of Green. The study did not cover issues the audit covered because Deloitte and Touche either were not provided certain data or were not asked to cover certain information.

Limiting the Subsidy. To limit the amount of subsidy required from patrons of the other AFRCs to the $ * planned to be contributed to the initial purchase price, Shades of Green room rates would have to be raised by $ * in excess of inflation during FY 1997. By doing so, AFRC-Orlando would generate sufficient cash flow to repay the amount due to the AMWRF (Appendix H and Appendix L).

Table 3 compares room rate ceiling limits as stipulated by the purchase agreement with suggested FY 1997 room rates. Any amount in excess of the annual ceiling rates must be shared 50/50 with Palm Hospitality Company. Increasing the average room rate by $ * will not exceed the annual room rate ceiling projected for FY 1997. The FY 1997 room rates exceed the estimated commercial room rates available by $13 to $55 (see Table 2).

*Proprietary data deleted.

Table 3. Room Rate Ceiling Limits

Category	FY 1996 Room Rates	FY 1997 Room Rates[1]	Start Ceiling[2]	Projected Ceiling[3]
I	$55	$71	$ 71	$ 75
II	79	96	103	109
III	89	107	105	111
IV	95	113	110	117

[1]The FY 1997 room rate is based on the FY 1996 rate escalated by 4 percent for inflation, plus a recommended increase of $ * .

[2]Ceiling limit for FY 1994.

[3]The projected ceiling limit reflects changes in hotel operating expenses calculated on a per occupied room night basis. It has been adjusted by an amount equal to the percentage increase in operating expenses.

Interest-Free Loan Subsidy. In addition to the patrons of other AFRCs and NAFIs subsidizing AFRC-Orlando with $27.2 million through FY 2010, AMWRF will advance the amount for the purchase of AFRC-Orlando with interest-free money from Army NAFIs. The AMWRF will receive an interest-free loan from the Army Banking and Investment Fund (ABIF) for the amount it provides to the purchase ($ *). The money loaned by the ABIF was money deposited by Army NAFIs that usually earn interest income on investments of about 7 percent. Therefore, the soldiers' money in the Army NAFIs was also subsidizing AFRC-Orlando. The AMWRF interest-free loan will be repaid over 14 years. If the AMWRF charged interest on the unpaid balance at 7 percent, the interest would be $ * in 1997 and $ * over 14 years (Appendix M).

Appropriated Funds. By using the CFSC HCMF to repay the $ * loan to purchase AFRC-Orlando and to provide another $ * toward the purchase of AFRC-Orlando in essence makes AFRC-Orlando a subsidy of the other AFRCs. From 1991 through 1995 $51.7 million in appropriated funds was used to subsidize AFRC-Europe. AFRC-Korea utilities were paid with $3.5 million of appropriated funds from FY 1991 through FY 1995. Without the transfer of appropriated funds to the AFRCs, no profits would be available to purchase AFRC-Orlando. Using funds from other AFRCs to subsidize the purchase and maintenance of AFRC-Orlando is an indirect use of appropriated funds.

*Proprietary data deleted.

Present Value of AFRC-Orlando

The AFRC-Orlando is unable to raise room rates to a level that would justify the $ * investment. The AFRC-Orlando is not a good business investment because it is unable to produce a discounted net cash flow equal to the $ * advanced for its purchase. AFRC-Orlando would have to raise room rates by $ * (Appendix N) in excess of inflation in FY 1997 for its discounted net cash flow from FY 1997 through FY 2010 to equal the investment cost (using a discount rate of 7 percent). A $ * increase in room rates at AFRC-Orlando in FY 1997 would increase category I rates, the lowest rates, to $ * . Because of competition with other lodging in the Orlando area, such as Disney's All-Star Resort with a 1995 rate of $ * for AFRC-Orlando overflow and a commercial rate of $69, AFRC-Orlando cannot raise room rates by $ * .

Patrons of AFRC-Orlando

Patrons of AFRC-Orlando include those outside the active duty category. Each year less than 1 percent (14,316) of the active duty military use AFRC-Orlando. Based on data provided by CFSC, about 5,700 category I active duty Service members benefited from AFRC-Orlando in a recent 1-year period. Of the 84,000 patrons and their dependents using AFRC-Orlando, 55 percent are active duty, 26 percent are retirees, 10 percent are civilian, 8 percent are Reserve and National Guard, and 1 percent is from a Disney sponsored Golf Classic. Patrons of other AFRCs and soldiers' money in the NAFIs are subsidizing the use of AFRC-Orlando by retirees (26 percent), civilians (10 percent), and golfers (1 percent). We do not believe the soldiers' money should be used to subsidize morale activities for others.

Summary

The AFRC-Orlando is not financially self-sustaining because CFSC has:

o established AFRC-Orlando room rates at financially unsupportable levels and

o used inaccurate projections of results of operations and cash flows at AFRC-Orlando.

*Proprietary data deleted.

As a result, CFSC has planned for the extensive subsidization of AFRC-Orlando through patrons of other AFRCs and soldiers' money from other NAFIs deposited in the ABIF.

Management Comments on the Finding and Audit Response

The Army commented extensively on the finding. See Appendix R for a summary of the Army's comments and audit response.

Recommendations, Management Comments, and Audit Response

B.1. We recommend that the Under Secretary of Defense (Personnel and Readiness) use alternative projections, as discussed in this report, of results of operations and cash flow for the Armed Forces Recreation Center-Orlando in the decision to terminate the purchase.

Under Secretary of Defense Comments. The Under Secretary did not provide comments on the draft report.

Army Comments. Although not required to comment, the Army nonconcurred with the recommendation. The Army stated that, based on PKF Consulting, the audit financial projections are wrong. The Army projects that cash flows will be adequate, based primarily on AFRC-Orlando maintaining a 98-percent occupancy rate and using the CFSC HCMF to repay the loan to purchase AFRC-Orlando, and on the availability of sufficient funds to cover capital expenditures and maintenance.

Audit Response. The Army comments were not responsive. The analysis not performed and information not considered by the PKF Consulting study are detailed in Appendix F. The use of the CFSC HCMF to repay the $ * loan to purchase AFRC-Orlando and to provide another $ * to purchase AFRC-Orlando is in essence a subsidy of AFRC-Orlando by the other AFRCs and NAFIs. From 1991 through 1995, $55.2 million in appropriated funds was used to subsidize AFRCs in Europe and Korea. When the Army MWR Board approved the purchase of AFRC-Orlando, the maintenance budgets of the other AFRCs were reduced by 25 percent. We contend that the affordability of

*Proprietary data deleted.

AFRC-Orlando should not depend on the repayment of AFRC-Orlando debt obligations using funds that were originally budgeted for maintenance work at the other AFRCs.

The audit projected the results of operations and cash flows using a 96-percent occupancy rate that was based on actual experience from February 1994 through May 1995. The Army's prediction of a 98-percent occupancy rate was based on the hotel experiencing a 99-percent occupancy rate for the 6 months ended July 31, 1995. The difference between the Army projections and the audit projections is about 5.7 room nights per day. However, the figures do not include maintenance problems and the seasonal tourist business in Florida that lowers occupancy in November, December, and January.

The cash set-aside for a Furnishing Reserve, included in the audit projections of AFRC-Orlando cash flows, substantially exceeded the budgeted AFRC-Orlando capital expenditures including those for furnishings. The Army not recognizing and budgeting for a Furnishing Reserve, in amounts required by the lease agreement, overstates the cash available for AFRC-Orlando general purposes. We request that the Under Secretary of Defense provide comments in response to the final report.

B.2. We recommend that the Commander, U.S. Army Community and Family Support Center:

a. Revise the projections of results of operations and cash flow of the Armed Forces Recreation Center-Orlando to reflect building depreciation, refurbishment depreciation, capital reinvestment assessment, required deposits to the maintenance fund, and room rental income based on experience and reservations.

Army Comments. The Army partially concurred. The Army stated that it revised the projected results of operations for AFRC-Orlando for FYs 1996 through 1999, to include depreciation; refurbishment depreciation; capital reinvestment assessment; and room rental income, based on experience and reservations. The Army stated that deposits to the maintenance fund are not operating expenses and should not be included in the results of operations.

Audit Response. The Army comments were partially responsive. For the same reasons cited in the audit response to the management comments for Recommendation B.1., the revised financial projections from the Army did not accurately estimate the results of operations and cash flows for AFRC-Orlando. We request that the Army reconsider its position and provide additional comments in response to the final report.

b. Contingent upon approval of the purchase of Armed Forces Recreation Center-Orlando, raise room rental rates in FY 1997 by the lesser of an increase to the ceiling rate or by at least $ * in excess of inflation.

Army Comments. The Army partially concurred, stating it will increase room rates an average of $5.99 per night beginning October 1, 1995. However, the Army stated that it is premature to determine room rates for FY 1997.

Audit Response. The Army comments were partially responsive. An average increase in room rates of $5.99 per night will be insufficient to operate AFRC-Orlando and repay the $ * AMWRF loan used to purchase AFRC-Orlando and accumulate an estimated $75 million for the renovation or rebuilding of the hotel. We included a room rate increase of $5.99 per night on October 1, 1995, in our calculations when we determined that an additional increase of $ * on October 1, 1996, was necessary for AFRC-Orlando to be self-sufficient. We request that the Army reconsider its position and provide additional comments in response to the final report.

*Proprietary data deleted.

Finding C. Maintenance Requirements

The AFRC-Orlando did not adequately program for long-term maintenance liabilities to maintain all aspects of Shades of Green to Disney standards. The condition occurred because CFSC had not developed a long-term maintenance plan for AFRC-Orlando and the financial means to support such a plan. As a result, AFRC-Orlando was projected to have $75 million in rebuilding costs, but only $31 million in the Furnishing Reserve fund in FY 2020 to pay for major renovation costs when the hotel is 47 years old. Further, CFSC must use cash flows from other AFRCs or NAFIs to pay unfunded long-term maintenance liabilities of AFRC-Orlando.

Reserve Fund Requirements

Hotels require continuous refurbishment and renovation to maintain the facilities. Because of constant wear and tear by hotel guests, the condition of hotel facilities declines rapidly. Disney generally requires hotels operating on the Walt Disney World Resort to set aside about 5 percent of their gross revenues in a maintenance reserve fund. The lease agreement between Palm Hospitality Company and the AMWRF requires the tenant to establish a separate Furnishing Reserve fund for the replacement and renewal of furnishings. The amount was specified in the AFRC-Orlando lease as 1 percent of gross receipts for each month during the first lease year, 2 percent for the second year, 3 percent for the third year, and 4 percent for the fourth year and all subsequent years. AMWRF is responsible for replacing all furniture, furnishings, equipment, and apparatus when necessary. If AMWRF fails to comply with operating standards or fails to perform maintenance and repairs, then Palm Hospitality Company (Disney) can act for the tenant and fix the problem. The AMWRF will then have to pay Palm Hospitality Company for the costs incurred plus interest. Palm Hospitality Company also has the option of terminating the agreement even if the building is purchased and rent is prepaid. In addition, hotel management needs to plan for major renovations of hotels to overcome functional obsolescence. Functional obsolescence occurs when the building exterior and facilities become out-of-date over a 15- to 20-year period.

Long-Term Maintenance Plan

The CFSC did not have a long-term maintenance plan for AFRC-Orlando and had no plans to provide funding for the long-term maintenance liabilities from AFRC-Orlando operations. However, CFSC had developed detailed annual capital expenditure budget plans for the other AFRC hotels. The plans indicated when an item or a project needed to be replaced. CFSC attempted to complete each hotel's capital projects and minor construction during a 5-year cycle.

Ongoing Maintenance at AFRC-Orlando. The CFSC personnel stated that they will refurbish AFRC-Orlando constantly so that over time they do not have an unmanageable 1-year cost of a major renovation. CFSC planned to refurbish guest rooms at a rate of one-third per year and completely refurbish each room every 3 years while maintaining an occupancy rate of 98 percent. Using industry standards, we identified and estimated the applicable costs for other items, such as televisions and furniture, that are replaced on a 10-year cycle. Refurbishment costs, which are shown in Appendix O, were estimated to be expenditures of the Furnishing Reserve.

Major Renovations at AFRC-Orlando. Usually a building depreciates in about 30 plus years. Likewise, General Services Administration standards estimate the life of a hotel building at 37 years. We selected FY 2020 as a basis for calculating and comparing rebuilding and refurbishing costs with balances in the Furnishing Reserve fund because, although most of AFRC-Orlando was built in 1973, Disney renovated the building in 1990. The hotel will be 47 years old in 2020. If the unspent funds in the maintenance reserve earn 5 percent interest per year, the maintenance reserve balance in FY 2020 will be $31 million (Appendix O).

Based on a 1991 appraised building value of $36 million, the estimated rebuilding costs in FY 2020 at 4 percent inflation will be $96 million (Appendix P). Further, based on the estimated per room cost of rebuilding another AFRC and escalating those costs 4 percent per year, we estimated the cost of rebuilding AFRC-Orlando to be $53 million in FY 2020 (Appendix P). We used the midpoint between the high range $96 million and the low range $53 million to estimate that $75 million will be needed in FY 2020 to rebuild the hotel. Because AFRC-Orlando will not have enough money in the reserve fund to cover rebuilding costs, the difference of $44 million ($75 million minus $31 million) will have to come from other sources. The CFSC personnel have stated that the money from HCMF will be used to rebuild AFRC-Orlando in the future. Therefore, in addition to paying off a $ * purchase loan for AFRC-Orlando through the HCMF, the other AFRC hotels also will be expected to pay major repair and rebuilding costs at AFRC-Orlando.

*Proprietary data deleted.

Hotel Industry Standard for Maintenance. The CFSC negotiated with Palm Hospitality Company to get the lower Furnishing Reserve fund requirement. According to Palm Hospitality Company staff, Disney always tries to comply with hotel industry maintenance standards and requires all non-Disney operated hotels, located on Disney ground to set aside at least 5 percent of their gross revenues in a maintenance reserve fund. To accumulate enough funds to pay for the estimated rebuilding cost of $75 million in FY 2020, AFRC-Orlando should raise FY 1997 room rates by $ * per night in excess of inflation. By doing so, the AFRC-Orlando cash flow from FY 2011 through FY 2020 will be $46.9 million, which will barely cover the shortage of maintenance funds of $44 million (Appendix Q). We are assuming that cash flow from FY 1997 through FY 2010 will be used to pay the AMWRF loan.

Phased Renovation of AFRC-Orlando

Phased renovation has become a hotel industry practice. By scheduling renovation in phases, huge one-time costs of renovation can be avoided. Hotels can avoid taking on large loans to finance renovation costs and can minimize disruption to hotel operations. If AFRC-Orlando refurbishes and rebuilds its facilities periodically and in phases, it can avoid building up large cash reserves in a sinking fund. By earning sufficient cash flow and planning to use its cash flow to periodically renovate and refurbish AFRC-Orlando, CFSC can reduce the AMWRF exposure to long-term maintenance liabilities.

Management Comments on the Finding and Audit Response

The Army commented extensively on the finding. See Appendix R for a summary of the Army comments and audit response.

*Proprietary data deleted.

Recommendations, Management Comments, and Audit Response

C. We recommend that, contingent upon the approval of the purchase of Armed Forces Recreation Center-Orlando, the Commander, U.S. Army Community and Family Support Center:

1. Develop a long-range maintenance plan, including phased renovation for refurbishment and rebuilding Armed Forces Recreation Center-Orlando.

Army Comments. The Army concurred with the recommendation.

Audit Response. The Army comments were responsive. However, we request the Army to provide us a proposed completion date and the key elements of the proposed long-range maintenance plan in its comments on the final report.

2. Finance the maintenance plan by using Armed Forces Recreation Center-Orlando generated cash flow.

Army Comments. The Army concurred and stated that AFRC-Orlando will generate adequate cash for repairs and maintenance in full compliance with Disney standards using annual operating expenses. The Army also stated that the HCMF will fund the capital expenditures as it does for all other AFRC hotels. Over the next 25 years AFRC-Orlando can be expected to contribute more than sufficient cash to the HCMF to comply with our recommendation.

Audit Response. We consider the Army comments partially responsive. The Army did not state how AFRC-Orlando will finance the long-range maintenance plan by using its own money. Instead, the Army only mentioned that HCMF will fund the capital expenditures for AFRC-Orlando. AFRC-Orlando cannot meet the self-sufficiency criteria with outside funding from HCMF. Therefore, we request that the Army provide detailed information on the financial means to be used to support a long-range maintenance plan using AFRC-Orlando generated cash flow in its comments on the final report.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope and Methodology

We reviewed the approval process for AFRC-Orlando and applicable DoD and Service regulations. We evaluated the lease terms, including maintenance liability and the requirement to establish the Furnishing Reserve fund. We also reviewed and analyzed the February 1994 through May 1995 financial statements for AFRC-Orlando, including a review of the audited financial statements for AFRC-Orlando dated, September 30, 1994. The financial statements were required to comply with MWR standards and generally accepted accounting principles. We also prepared estimates of the results of operations, cash flow, and the Furnishing Reserve Fund from FY 1996 through FY 2020. We also reviewed the April 1995 Deloitte and Touche "Shades of Green/Army Operating Fund Evaluation" and the August 1995 PKF Consulting evaluation of the draft audit report.

Use of Computer-Processed Data. We used computer-processed data from the AFRC-Orlando central reservation system. We also reviewed computer generated financial statements. The reservation and financial data were reliable and we used them to determine the current and future occupancy and average daily room rates and projected income and cash flows for AFRC-Orlando.

Use of Technical Assistance. The Quantitative Methods Division provided technical assistance with financial projections of AFRC-Orlando's net income and cash flows. The projections were not statistical.

Audit Period, Standards, and Locations. We performed this financial-related audit from May through mid-August 1995 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. Appendix T lists the organizations we visited or contacted.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of the AFRC-Orlando management control program as related to funds control and financial statement preparation. We reviewed AFRC-Orlando's FY 1994 Annual Statement of Assurance and the checklists used to prepare that statement.

Adequacy of Management Controls. The AFRC-Orlando management controls we reviewed were adequate in that we identified no material management control weaknesses. The issues raised in this report do not pertain to management controls.

Appendix B. Summary of Prior Audits and Other Reviews

General Accounting Office

General Accounting Office Report No. NSIAD-94-120 (OSD Case No. 9621), "Morale, Welfare, and Recreation Declining Funds Require DoD to Take Action," February 28, 1994, states that the financial outlook of the MWR program appears to be worsening. Revenue generated by MWR activities is likely to decrease in the 1990s because of the downsizing of forces and the increasing private sector competition. The report cited an August 1993 Logistics Management Institute study that showed, based on generally accepted accounting principles, the Army welfare and recreation business programs lost $72 million in FY 1991. The report recommended that the Secretary of Defense complete a strategic MWR review and implement guidance to improve the management and oversight of the MWR program and to ensure that the Services have sound management strategies that anticipate the likelihood that MWR funding will decline faster than costs. The report also recommended that the Secretary of the Army delay the further obligation of funds for MWR capital improvement and construction projects until such projects are shown to be sound investments and redirect funds to efforts that will increase MWR profits or lower MWR expenses. The Army concurred with the recommendation to develop a strategic plan for MWR. Further, the Army concurred with the intent of the recommendation to fund projects that are sound investments and that increase profitability. The Army stated that some exceptions may be made, such as quality of life services, because the best use of funds encompasses more than profitability.

Inspector General, DoD

Inspector General, DoD, (IG, DoD) Report No. 95-087, "Armed Forces Recreation Center-Orlando," January 27, 1995, states that AFRC-Orlando financial operations for the first 4 months did not meet the MWR standards of having a break even or positive net income before depreciation. The report also states that the Army cannot afford to continue to operate AFRC-Orlando under the existing lease terms because of the high cost of land and building rents. The report recommended that the Army evaluate the existing room-rate structure and

take the actions necessary to make the operations self-sustaining, to include increasing existing and future room rates. The report also recommended that the Army establish a plan to evaluate the future of AFRC-Orlando and terminate the lease if it cannot be self-sustaining and if sufficient funds are not available for the lease options. The Army partially concurred with evaluating the room-rate structuring, agreeing to adopt a new room-rate structure but not agreeing to increase room rates. The Army concurred with meeting MWR standards to be self-sustaining. The Army plans to purchase the hotel buildings and prepay land rent. Room rates were also increased.

The IG, DoD, Report No. 94-047, "Armed Forces Center-Europe," February 28, 1994, states, in part, that the AFRC-Europe was not capable of being self-sustaining without being subsidized with appropriated fund support even though the AFRC operated at near capacity. For FYs 1991 and 1992, AFRC-Europe reported a net operating loss of $2.2 million, after $29.7 million of appropriated and about $5 million of nonappropriated funds subsidies. In addition, the report states that AFRC-Europe incorrectly used appropriated funds in the amount of $1.6 million to maintain, clean, and improve the facilities during FYs 1991 and 1992. The report recommended that the Army determine whether AFRC-Europe is necessary and perform a study to determine whether AFRC-Europe can exist as a self-sustaining business (without appropriated fund support). In addition, the report recommended that the Army reimburse $1.6 million of incorrectly used appropriated funds. The Army agreed to conduct a study that would consider the demand for AFRC-Europe, the impact of changing the rate structure, and the status of comparable local competition. The Army did not agree to reimburse $1.6 million of nonappropriated funds to the proper appropriated funds account because guidance was not clear.

Army Audit Agency

Army Audit Agency Report No. NR 94-C11, "Use of Appropriated Funds, Armed Forces Center-Europe," September 28, 1994, followed up on Inspector General, DoD Report No. 94-047. The Army Audit Agency report confirmed that $393,000 of $611,000 appropriated funds reviewed in Report No. 94-047 were used incorrectly. The report also stated that an additional $2 million of $20 million in expenditures did not qualify for appropriated fund support and that there was an apparent funding violation when $116,000 of FY 1991 funds were used for FY 1992 purchases. The report suggested that the Army issue guidance specific to the AFRCs and guidance on what specific functions and activities could be supported with appropriated funds. The Army concurred with the suggestions and repaid the $116,000.

Army Audit Agency Report No. SR 94-C17, "Review of Nonappropriated Fund Cash Levels," June 14, 1994, states that the Army's nonappropriated fund cash balances were within reasonable limits for FYs 1993 and 1994. However, forecasted cash balances decreased below a sound financial position for FY 1995 through FY 1998. The report also states that CFSC was not appropriately showing nonappropriated fund cash balances and solvency ratios in its cash flow statements. The report also stated that CFSC solvency criteria (cash-to-debt ratios) for nonappropriated fund balances were not in accordance with generally accepted accounting principles. The report suggested that CFSC include solvency ratios with footnotes and planned actions to adjust the cash balances for anticipated excess or shortfalls in operations in its quarterly cash flow projections. The report also suggested that CFSC review and approve cash flow projections, revise minimum operating cash requirements guidance, and provide guidance in a clear format. CFSC agreed with all of the suggestions.

Appendix C. Performance Indicators

Performance Indicators

We reviewed performance indicators, including financial statements; occupancy; and reservations. We noted there were some problems in financial projections for the AFRC-Orlando as discussed in Finding B. We did not note any problems in occupancy or reservation information.

Appendix D. U.S. Army Community and Family Support Center Memorandum on Contracting for Services

DEPARTMENT OF THE ARMY
U.S. ARMY COMMUNITY AND FAMILY SUPPORT CENTER
ALEXANDRIA, VA 22331-05

REPLY TO ATTENTION OF

July 20, 1995

CFSC-HD

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE (AUDITING)

SUBJECT: Privatizing Hotel Services and Recreational Travel Services Provided by Shades of Green (SOG)

This is in response to your memorandum of July 13, 1995, subject as above. Discussions with General Robert W. RisCassi (Ret.), a member of the Commission on Roles and Missions of the Armed Forces and Mr. Michael Leonard, Executive Director of the Commission, have reaffirmed the intent of the Commission in this regard. The Commission recommended outsourcing/ privatization of functions whereby significant reductions of appropriated fund expenses, direct or personnel authorizations, can be achieved. The commission chose to specifically exclude commissaries and exchanges from the 30 major functional areas they reviewed and never considered including Category C morale, welfare, and recreation activities operated by the services.

During the initial SOG feasibility study, the Army considered several management options including privatization. The primary goal of Armed Forces Recreation Centers (AFRCs) is to advantage soldiers and their families by providing quality, wholesome vacation opportunities at a financial advantage. In this case, privatization all but eliminates those goals and was therefore, considered and disregarded as a feasible option. Private management of SOG would have the following major financial impacts:

As SOG is a Nonappropriated Fund Instrumentality:

- The Florida State Taxation Authority has determined that the landlord is exempt from the annual Florida State Property Tax. That tax was $863,000 in 1993, the last year the landlord operated the hotel, and would be passed on to a private contractor. The contractor would pass that cost to patrons. That expense would cause an $8.50 per night addition to room rates.

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SUBJECT: Privatizing Hotel services and recreational Travel Services Provided by Shades of Green (SOG)

- SOG patrons are exempt from the 10 percent Florida State Room Tax. A private contractor would not be exempt. That tax would cause a $7.20 per night addition to room rates.

- SOG patrons are exempt from 6 percent sales tax on food, beverage, sundry products, and attraction admission tickets. A private contractor would not be exempt. That tax would increase patron cost of all goods and services at SOG by 6 percent.

- SOG is exempt from local, State, and Federal corporate taxes. A private contractor would not be exempt. The cost of such taxation would be dependent on operating results but would ultimately increase costs to patrons.

- SOG is exempt from the 6 percent sales tax on all goods and services it purchases. Cost avoidance in the last 12 months has been $198,000. A private contractor would not be exempt and that cost would be passed on to patrons.

If SOG is purchased and rent expense is eliminated, it will generate an annual net income before depreciation approximately equal to the landlord's pre-tax net income when they operated the hotel. To obtain that amount of profit they had to charge an average daily rate of $142 whereas SOG will average $78. Presumably a private contractor would also have to charge such rates in order to achieve a reasonable profit. In that case, the rationale for having an AFRC is eliminated.

If SOG were operated as an AFRC by a private contractor with patronage limited to Department of Defense members, the contractor would doubtlessly require a guaranteed level of annual profit, underwriting of commercial debt service and a contract termination buyout guarantee. These would all be considerable contingent liabilities to the Army Morale, Welfare, and Recreation Fund (AMWRF), which in this case the Army considers to be unacceptable.

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CFSC-HD
SUBJECT: Privatizing Hotel Services and Recreational Travel Services Provided by Shades of Green (SOG)

Additional conditions which mitigate against private management include:

- The Army and Air Force Exchange Service (AAFES) store at SOG, where customers get a 25 percent base price cost savings compared to comparable stores on Walt Disney World® Resort, plus a 6 percent tax avoidance, could not operate in a privately managed hotel.

- Walt Disney World® absolutely will not offer the same degree of admission ticket discounts to a private operator that it does for the Army.

- The landlord would require advance approval of a private company.

Possible intentions of the Commission on Roles and Missions of the Armed Forces notwithstanding, the US Senate has taken the following view of SOG as contained in the language of the Committee on Armed Services, US Senate, Report on the National Defense Authorization Act for Fiscal Year 1995.

<u>Establishment of the first armed forces recreation center in the continental United States.</u>

"The committee commends the Department of Defense and Department of the Army for the establishment of Shades of Green, the first armed forces recreation center in the continental United States. This endeavor represents the finest tradition of the military taking care of its own at no cost to the American taxpayer. The Army Community and Family Support Center has demonstrated keen foresight in positioning this morale building benefit for a defense force that will be increasingly based in the United States, and displayed great tenacity in pursuing a quality recreation opportunity for all ranks, especially junior enlisted grades.

Since 1945, the Defense Department has provided armed forces recreation services to our troops overseas. The popularity and value of their services to morale and

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CFSC-HD
SUBJECT: Privatizing Hotel Services and Recreational Travel Services Provided by Shades of Green (SOG)

> readiness has long been recognized and documented. Providing this service in the United States demonstrates both foresight and a caring attitude by Army leadership."

The Army has previously considered and rejected the option of private operation of SOG and does not intend to re-evaluate the issue. This position is consistent with the purpose of AFRCs as well as the recommendations of the Commission on Roles and Missions of the Armed Forces.

Russell C. Favil COL Chief of Staff
JOHN G. MEYER, JR.
Brigadier General, USA
Commanding

CF:
DASD (PSF&E)

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Appendix E. Comparisons of Expense Items and Business Risks For Different Types of Ownership

	Army Owned[1]	Central Reservation System[2]
Expenses		
Hotel operations	X	
Interest	X	
Loan/rent	X	
Long-term maintenance	X	
Personnel	X	X
Start-up cost	X[3]	X
Telephone	X	X
Termination	X	
Business Risks		
Deployment of patrons or energy crisis	X	
Disney terminates agreement	X	
Disney World loses commercial appeal	X	
Hotel technical obsolescence	X	
Natural disaster	X	

[1]The Army exercises the purchase option and owns the AFRC-Orlando for 100 years.

[2]CFSC invests $0.5 million or less for room reservation equipment and facilities.

[3]Already incurred.

Appendix F. Pannell Kerr Forster Consulting Evaluation

The PKF Consulting review entitled, "Review and Assessment of Financial and Related Issues in Connection with Shades of Green Hotel Orlando, Florida," is in response to our draft report. The Army hired the private consulting firm to conduct an on-site assessment of the physical attributes and financial and related issues of AFRC-Orlando in August 1995. The following table compares the PKF Consulting review and our audit.

Comparison Between PKF Consulting Review and IG, DoD, Followup Audit of AFRC-Orlando

Areas Compared	PKF Consulting	IG, DoD
Projected cash flow	Did not consider annual loan payment of $ * and maintenance fund contributions of $0.8 million.	Considered annual loan payment and maintenance reserve fund.
Reservation system:		
Initial costs	$855,600. Projected $201,961 net loss.	$500,000. Patrons will obtain cheaper room rates than at AFRC-Orlando. No long-range financial and maintenance liabilities.
General manager	Required. $78,000 cost, including salary and benefits.	Not required. Office can be managed by Reservations manager. The $78,000 cost also appears high.

*Proprietary data deleted.

Areas Compared	PKF Consulting	IG, DoD
800 telephone number for reservation system	Required. $200,000 cost.	Not required. Reservations can be made through Army Central Reservation System, toll free.
Phone equipment	$50,000	AFRC-Orlando purchased phone equipment during start-up.
Assumptions used in financial projections:		
Occupancy Rate	98 percent.	96 percent. Considered the inconvenience to guests due to hotel renovations and seasonal fluctuations.
Average daily room rate	$77.48 in FY 96. $80.58 in FY 97. $83.80 in FY 98. $87.15 in FY 99.	$75.50 in FY 96 $78.52 in FY 97 $81.66 in FY 98 $84.93 in FY 99
Long-term maintenance liabilities	Considered. $20.8 million liability in 1995 dollars.	Considered. $75 million liability in year 2020 assuming a 4-percent inflation rate. If the PKF Consulting $20.8 million in 1995 dollars is increased by 4 or 5 percent inflation, then amount would approximate the IG, DoD, projections.

Areas Compared	PKF Consulting	IG, DoD
Hotel data base	Included 1,000 full service hotels for 21-year period and 196 well-maintained hotels for 11-year period. Short-term maintenance liabilities considered, but no mention of liabilities over 100-year lease term. No mention of return of hotel to Disney at end of lease.	Considered 100-year leasehold liabilities. Considered return of hotel to Disney at end of lease.
Functional obsolescence	Not considered	Considered. Hotels require massive renovation between 15th and 20th years according to the president of the largest organization specializing in hotel and motel valuation. Also, in 2020, the hotel will be 47 years old.
Other areas:		
On-site engineering assessment	Not performed. Actual structural condition not known.	Not performed.

Appendix F. Pannell Kerr Forster Consulting Evaluation

Areas Compared	PKF Consulting	IG, DoD
Orlando hotel market	Not reviewed.	Reviewed. Noted Orlando area not attractive for hotel investment due to oversupply according to a 1995 article by Hospitality Valuation Services.
Life cycle of hotel	Not considered.	Considered. Hotels are characterized by rapid growth in first 10 years, followed by stabilized income over next 15 years. Net income declines near the end of the hotel's functional economic life and its income generating capacity decreases.

Appendix G. Projections of Armed Forces Recreation Center-Orlando Income and Cash Flows Without FY 1997 Room Rate Increase

Table G-1. Income and Cash Flows Without Annual Loan Repayment

	FY 1996 (millions)	FY 1997 (millions)	FY 1998 (millions)	FY 1999 (millions)	FY 2000 (millions)	FY 2005 (millions)	FY 2010 (millions)	FY 2015 (millions)	FY 2020 (millions)
Income									
Gross revenues	$18.92	$19.68	$20.46	$21.28	$22.13	$26.92	$32.76	$39.86	$48.49
Costs/expenses	17.34	18.22	18.93	19.40	20.17	24.54	29.86	36.33	44.20
Income before depreciation	**1.58**	**1.46**	**1.53**	**1.88**	**1.96**	**2.38**	**2.90**	**3.53**	**4.29**
Depreciation[1]	1.36	1.68	1.68	1.68	1.63	1.67	2.31	1.85	1.91
Net Income	**$ 0.22**	**($ 0.22)**	**($ 0.15)**	**$ 0.20**	**$ 0.33**	**$ 0.71**	**$ 0.59**	**$ 1.68**	**$ 2.38**
Cash Flows[2]									
Income before depreciation	$1.58	$1.46	$1.53	$1.88	$1.96	$2.38	$2.90	$3.53	$4.29
Add:									
Preopening costs amortized	0.28	0.28	0.28	0.00	0.00	0.00	0.00	0.00	0.00
Less:									
ARMTF[3] loan	(0.38)	(0.37)	(0.38)	(0.37)	(0.38)	(0.00)	(0.00)	(0.00)	(0.00)
Maintenance fund contributions	(0.56)	(0.79)	(0.81)	(0.85)	(0.88)	(1.07)	(1.31)	(1.60)	(1.94)
Net Cash Flow	**$0.92**	**$0.58**	**$0.62**	**$0.66**	**$0.70**	**$1.31**	**$1.59**	**$1.93**	**$2.35**

[1]Depreciation of buildings, improvements, fixtures, and equipment was held at $1.4 million per year, plus the costs of refurbishments written off entirely the year after the scheduled refurbishment was completed.

[2]Excludes about $ * annually during FYs 1997 through 2010 to pay the $ * loan from the AMWRF to buy AFRC-Orlando.

[3]Army Recreation Machine Trust Fund loan for start-up costs.

*Proprietary data deleted.

Appendix G. Projections of Armed Forces Recreation Center-Orlando Income and Cash Flows Without FY 1997 Room Rate Increase

Table G-2. Income and Cash Flows with Annual Loan Repayment

	FY 1996 (millions)	FY 1997 (millions)	FY 1998 (millions)	FY 1999 (millions)	FY 2000 (millions)	FY 2005 (millions)	FY 2010 (millions)	FY 2015 (millions)	FY 2020 (millions)
Income									
Gross revenues	$18.92	$19.68	$20.46	$21.28	$22.13	$26.92	$32.76	$39.86	$48.49
Costs/expenses	17.34	18.22	18.93	19.40	20.17	24.54	29.86	36.33	44.20
Income before depreciation	**1.58**	**1.46**	**1.53**	**1.88**	**1.96**	**2.38**	**2.90**	**3.53**	**4.29**
Depreciation[1]	1.36	1.68	1.68	1.68	1.63	1.67	2.31	1.85	1.91
Net Income	**$ 0.22**	**($ 0.22)**	**($ 0.15)**	**$ 0.20**	**$ 0.33**	**$ 0.71**	**$ 0.59**	**$ 1.68**	**$ 2.38**
Cash Flows									
Income before depreciation	$1.58	$ 1.46	$ 1.53	$ 1.88	$ 1.96	$ 2.38	$ 2.90	$3.53	$4.29
Add:									
Preopening costs amortized	0.28	0.28	0.28	0.00	0.00	0.00	0.00	0.00	0.00
Less:									
ARMTF[2] loan	(0.38)	(0.37)	(0.38)	(0.37)	(0.38)	(0.00)	(0.00)	(0.00)	(0.00)
Maintenance fund contributions	(0.56)	(0.79)	(0.81)	(0.85)	(0.88)	(1.07)	(1.31)	(1.60)	(1.94)
Cash flows before AMWRF loan payment	**0.92**	**0.58**	**0.62**	**0.66**	**0.70**	**1.31**	**1.59**	**1.93**	**2.35**
Less:									
AMWRF loan payment	0.00	(*)	(*)	(*)	(*)	(*)	(*)	(0.00)	(0.00)
Net Cash Flow[3]	**$0.92**	**($ *)**	**($ *)**	**($ *)**	**($ *)**	**($ *)**	**($ *)**	**$ ***	**$ ***

[1]Depreciation of buildings, improvements, fixtures, and equipment was held at $1.4 million per year, plus the costs of refurbishments written off entirely the year after the scheduled refurbishment was completed.

[2]Army Recreation Machine Trust Fund loan for start-up costs.

[3]Total of net cash flow through the end of the AMWRF loan repayment period (FY 2010) is a negative $ * .

*Proprietary data deleted.

Appendix H. Armed Forces Recreation Center-Orlando Cash Flow Projections

Year	Current Room Rates[1] (millions)	$8 Increase in Room Rates in FY 1997[2] (millions)	$ * Increase in Room Rates in FY 1997[3] (millions)
1996	$ 0.92	$ 0.92	$ 0.92
1997	0.58	1.32	1.89
1998	0.62	1.39	1.97
1999	0.66	1.46	2.07
2000	0.70	1.54	2.16
2001	0.74	1.61	2.27
2002	0.79	1.69	2.37
2003	0.83	1.77	2.48
2004	1.26	2.24	2.97
2005	1.31	2.32	3.09
2006	1.36	2.42	3.21
2007	1.41	2.52	3.34
2008	1.47	2.62	3.47
2009	1.53	2.72	3.61
2010	1.59	2.83	3.76
Total	**$15.77**	**$29.37**	**$39.58**

[1]AFRC-Orlando 14-year cash flow projected at 4 percent inflation. Loan payment begins in FY 1997.

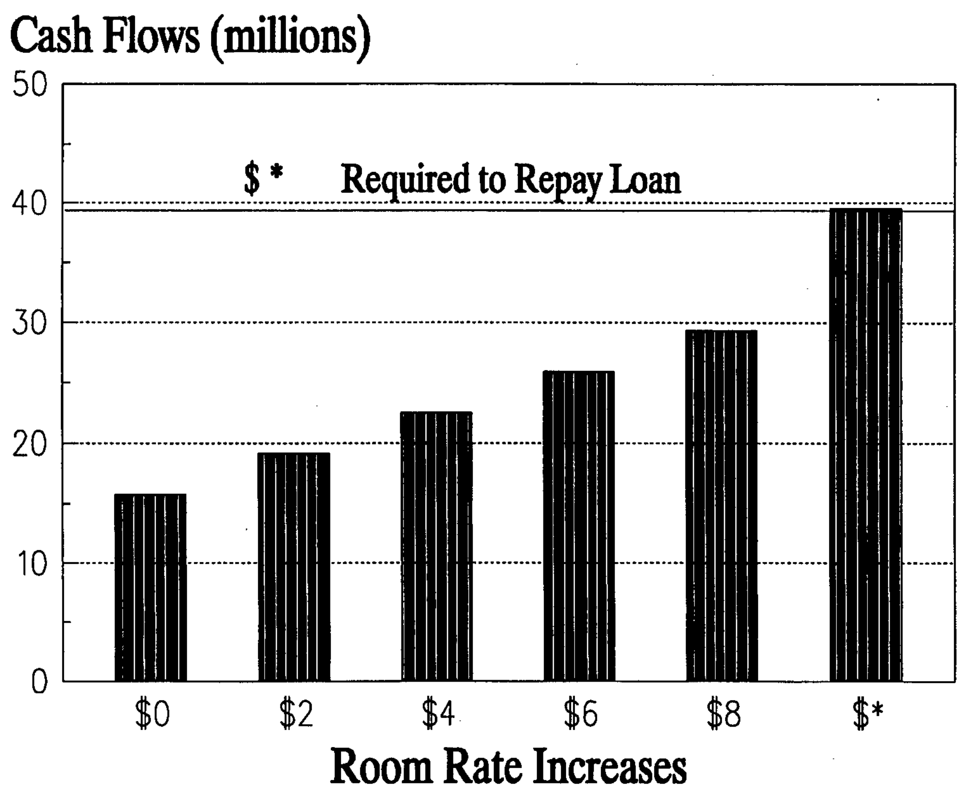
[2]AFRC-Orlando 14-year cash flow projected at 4 percent inflation with an $8 increase in room rates in FY 1997.

[3]AFRC-Orlando 14-year cash flow projected at 4 percent inflation with a $ * increase in room rates in FY 1997.

[4]These amounts are before payment of the $ * loan.

*Proprietary data deleted.

Appendix I. Armed Forces Recreation Center-Orlando Forecast of 14-Year Cash Flows at Various Room Rate Increases in FY 1997



A $* room rate increase will provide enough cash flow to repay $ * loan

*Proprietary data deleted.

Appendix J. Cash Flows of Other Armed Forces Recreation Center Hotels

The following lists the net increase and decrease in cash flow[1].

Hotel	FY 1992 (millions)	FY 1993 (millions)	FY 1994 (millions)
AFRC-Europe[2]	$ 0.76	($0.49)	$2.10
Dragon Hill,[3] Republic of Korea	0.34	(0.85)	1.48
Hale Koa, Hawaii	(2.48)	1.08	(0.97)
Net Cash Flows[4]	**($1.38)**	**($0.26)**	**$2.61**

[1]Information taken from hotel financial statements audited by certified public accountants.

[2]The financial statement results do not include appropriated fund subsidies of $12.3 million in FY 1992, $8.5 million in FY 1993, and $8.2 million in FY 1994 provided to AFRC-Europe. Without the $29 million of appropriated funds there would have been large financial losses.

[3]The financial statement results do not include appropriated fund subsidies of $700,000 from FY 1992 through FY 1994. Without the $2.1 million of appropriated fund subsidies, losses would have occurred in FYs 1992 and 1993.

[4]Combined net cash flow for 3 years was $0.97 million. If appropriation subsidies are considered, the net cash flow is a loss of $30 million ($0.97 million minus $31.1 million).

Appendix K. Deloitte and Touche Evaluation of AFRC-Orlando

Deloitte and Touche's evaluation of AFRC-Orlando entitled, "Shades of Green/Army Operating Funds Evaluation," was limited in scope. The Army directed that Deloitte and Touche determine whether various Army funds had the capacity to purchase AFRC-Orlando. Deloitte and Touche was not asked to address whether AFRC-Orlando would be self-sustaining and to perform sensitivity analyses to project AFRC-Orlando's finances. Additionally, Deloitte and Touche did not address long-term maintenance liabilities. The following table compares the Deloitte and Touche evaluation and our audit.

Comparison Between Deloitte and Touche Evaluation and IG, DoD, Followup Audit of AFRC-Orlando

Areas Compared	Deloitte and Touche	IG, DoD
Self-sustaining criteria	Not considered. No discussion of subsidizing AFRC-Orlando with money from other AFRC hotel patrons; and no discussion of interest-free loan of the soldiers' money in Army Banking and Investment Fund.	Considered.
Loan payment	Evaluated the HCMF ability to repay AMWRF loan to purchase AFRC-Orlando through the HCMF cash flow.	Evaluated AFRC-Orlando's ability to repay loan through AFRC-Orlando's cash flow and the HCMF cash flow.
Sensitivity analyses	Did not consider room rate increases needed for AFRC-Orlando to be self-sustaining.	Performed sensitivity analyses on room rate increases within self-sustaining criteria.

Appendix K. Deloitte and Touche Evaluation of Armed Forces Recreation Center-Orlando

Areas Compared	Deloitte and Touche	IG, DoD
Assumptions used in financial projections:		
Occupancy rate	Revised downward to experience	Revised downward to experience.
Average daily room rate	$73.00	$75.50
Capital reinvestment assessment	Not included; goes up to 3 percent of gross revenues.	Included.
Building depreciation	Not included; million dollar annual expense.	Included.
Long-term maintenance liabilities	Not considered. Used CFSC supplied figure of 30 percent of net income before depreciation as maintenance cost. Ignored refurbishment costs and cycles. Ignored rebuilding costs.	Considered. Used independent cost estimates of rebuilding AFRC-Orlando and cost of renovating as a basis of estimating renovation costs. Calculated refurbishment costs based on actuals and American Hotel and Motel Association provided standards.

Appendix L. Projections of Armed Forces Recreation Center-Orlando Income and Cash Flows With Average Room Rate Increase of $ * per Night Beginning FY 1997

Table L-1. Income and Cash Flows Without Annual Loan Repayment

	FY 1996 (millions)	FY 1997 (millions)	FY 1998 (millions)	FY 1999 (millions)	FY 2000 (millions)	FY 2005 (millions)	FY 2010 (millions)	FY 2015 (millions)	FY 2020 (millions)
Income									
Gross revenues	$18.92	$21.08	$21.92	$22.79	$23.71	$28.84	$35.09	$42.70	$51.94
Costs/expenses	17.34	18.26	18.98	19.44	20.22	24.60	29.93	36.42	44.30
Income before depreciation	**1.58**	**2.82**	**2.94**	**3.35**	**3.49**	**4.24**	**5.16**	**6.28**	**7.64**
Depreciation[1]	1.36	1.68	1.68	1.68	1.63	1.67	2.31	1.85	1.91
Net Income	**$ 0.22**	**$ 1.14**	**$ 1.26**	**$ 1.67**	**$ 1.86**	**$ 2.57**	**$ 2.85**	**$ 4.43**	**$ 5.73**
Cash Flows[2]									
Income before depreciation	$1.58	$2.82	$2.94	$3.35	$3.49	$4.24	$5.16	$6.28	$7.64
Add:									
Preopening costs amortized	0.28	0.28	0.28	0.00	0.00	0.00	0.00	0.00	0.00
Less:									
ARMTF[3] loan	(0.38)	(0.37)	(0.38)	(0.37)	(0.38)	(0.00)	(0.00)	(0.00)	(0.00)
Maintenance fund contributions	(0.56)	(0.84)	(0.87)	(0.91)	(0.95)	(1.15)	(1.40)	(1.71)	(2.08)
Net Cash Flows	**$0.92**	**$1.89**	**$1.97**	**$2.07**	**$2.16**	**$3.09**	**$3.76**	**$4.57**	**$5.56**

[1]Depreciation of buildings, improvements, fixtures, and equipment was held at $1.4 million per year, plus the costs of refurbishments written off entirely the year after the scheduled refurbishment was completed.

[2]Excludes about $ * annually during FYs 1997 through 2010 to pay the $ * loan from the AMWRF to buy AFRC-Orlando.

[3]Army Recreation Machine Trust Fund loan for start-up costs.

*Proprietary data deleted.

Appendix L. Projections of Armed Forces Recreation Center-Orlando Income and Cash Flows With Average Room Rate Increase of $ * per Night Beginning FY 1997

Table L-2. Income and Cash Flows with Annual Loan Repayment

	FY 1996 (millions)	FY 1997 (millions)	FY 1998 (millions)	FY 1999 (millions)	FY 2000 (millions)	FY 2005 (millions)	FY 2010 (millions)	FY 2015 (millions)	FY 2020 (millions)
Income									
Gross revenues	$18.92	$21.08	$21.92	$22.79	$23.71	$28.84	$35.09	$42.70	$51.94
Costs/expenses	17.34	18.26	18.98	19.44	20.22	24.60	29.93	36.42	44.30
Income before depreciation	**1.58**	**2.82**	**2.94**	**3.35**	**3.49**	**4.24**	**5.16**	**6.28**	**7.64**
Depreciation[1]	1.36	1.68	1.68	1.68	1.63	1.67	2.31	1.85	1.91
Net Income	**$ 0.22**	**$ 1.14**	**$ 1.26**	**$ 1.67**	**$ 1.86**	**$ 2.57**	**$ 2.85**	**$ 4.43**	**$ 5.73**
Cash Flows									
Income before depreciation	$1.58	$ 2.82	$ 2.94	$ 3.35	$ 3.49	$ 4.24	$5.16	$6.28	$7.64
Add:									
Preopening costs amortized	0.28	0.28	0.28	0.00	0.00	0.00	0.00	0.00	0.00
Less:									
ARMTF[2] loan	(0.38)	(0.37)	(0.38)	(0.37)	(0.38)	(0.00)	(0.00)	(0.00)	(0.00)
Maintenance fund contributions	(0.56)	(0.84)	(0.87)	(0.91)	(0.95)	(1.15)	(1.40)	(1.71)	(2.08)
Cash flows before AMWRF loan payment	**0.92**	**1.89**	**1.97**	**2.07**	**2.16**	**3.09**	**3.76**	**4.57**	**5.56**
Less:									
AMWRF loan payment	0.00	(*)	(*)	(*)	(*)	(*)	(*)	(0.00)	(0.00)
Net Cash Flow[3]	**$0.92**	**($ *)**	**($ *)**	**($ *)**	**($ *)**	**$ ***	**$ ***	**$ ***	**$ ***

[1]Depreciation of buildings, improvements, fixtures, and equipment was held at $1.4 million per year, plus the costs of refurbishments written off entirely the year after the scheduled refurbishment was completed.

[2]Army Recreation Machine Trust Fund loan for start-up costs.

[3]Total of net cash flow through the end of the AMWRF loan repayment period (FY 2010) is a positive $ * .

*Proprietary data deleted.

Appendix M. Imputed Interest Cost

The ABIF will provide an interest-free loan of $ * to the AMWRF to purchase AFRC-Orlando. The AMWRF will repay the loan in 14 annual installments of $ * . The following table shows the interest that would be paid if AFRC-Orlando had to pay interest at 7 percent on the AMWRF loan.

Fiscal Year	Loan Payment (millions)	Loan Balance[1] (millions)	Interest (millions)
1996			
1997			
1998			
1999			
2000			
2001			
2002			
2003		Proprietary data deleted.	
2004			
2005			
2006			
2007			
2008			
2009			
2010			
Total			

[1]Loan balance less $ * loan payment each year beginning in FY 1997. The loan balance mathematically may not match the loan balance minus loan payment due to rounding.

*Proprietary data deleted.

Appendix N. Comparison Between the Estimated and Discounted Cash Flows for Selected FY 1997 Room Rate Increases, Discounted at 7 Percent

	$0 Increase		$ * Increase		$ * Increase	
Fiscal Year	Estimated Amount (millions)	Discounted Amount (millions)	Estimated Amount (millions)	Discounted Amount (millions)	Estimated Amount (millions)	Discounted Amount (millions)
1997	$ 0.58	$0.58	$ 1.89	$ 1.89	$ 3.18	$ 3.18
1998	0.62	0.58	1.97	1.84	3.33	3.11
1999	0.66	0.57	2.07	1.80	3.47	3.03
2000	0.70	0.57	2.16	1.77	3.63	2.96
2001	0.74	0.57	2.27	1.73	3.79	2.89
2002	0.79	0.56	2.37	1.69	3.95	2.82
2003	0.83	0.55	2.48	1.65	4.13	2.75
2004	1.26	0.78	2.97	1.85	4.68	2.92
2005	1.31	0.76	3.09	1.80	4.87	2.83
2006	1.36	0.74	3.21	1.75	5.06	2.76
2007	1.41	0.72	3.34	1.70	5.27	2.68
2008	1.47	0.70	3.47	1.65	5.48	2.60
2009	1.53	0.68	3.61	1.60	5.70	2.53
2010	1.59	0.66	3.76	1.56	5.93	2.46
Total	**$14.85**	**$9.02**	**$38.66**	**$24.28**	**$62.47**	**$39.52**

*Proprietary data deleted.

Appendix O. Estimated Revenues and Furnishing Reserve Fund Activity From FY 1996 Through FY 2020

	FY 1996 (millions)	FY 1997 (millions)	FY 1998 (millions)	FY 1999 (millions)	FY 2000 (millions)	FY 2001 (millions)	FY 2002 (millions)	FY 2003 (millions)	FY 2004 (millions)
Revenue	$18.9	$19.7	$20.5	$21.3	$22.1	$23.0	$24.0	$24.9	$25.9
Maintenance Fund									
Beginning balance[1]	0.5	0.8	1.3	1.9	2.6	3.4	3.8	4.2	4.7
From gross revenues[2]	0.6	0.8	0.8	0.9	0.9	0.9	0.9	1.0	1.0
Less: Refurbishment costs[3]	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)	(0.7)	(0.7)	(0.7)	(0.3)
Interest income[4]	0.04	0.06	0.09	0.1	0.2	0.2	0.2	0.2	0.3
Ending Balance	**$ 0.8**	**$ 1.3**	**$ 1.9**	**$ 2.6**	**$ 3.4**	**$ 3.8**	**$ 4.2**	**$ 4.7**	**$ 5.7**

	FY 2005 (millions)	FY 2006 (millions)	FY 2007 (millions)	FY 2008 (millions)	FY 2009 (millions)	FY 2010 (millions)	FY 2011 (millions)	FY 2012 (millions)	FY 2013 (millions)
Revenue	$26.9	$28.0	$29.1	$30.3	$31.5	$32.8	$34.1	$35.4	$36.9
Maintenance Fund									
Beginning balance[1]	5.7	6.8	7.9	9.2	9.9	10.7	11.7	13.2	14.9
From gross revenues[2]	1.1	1.1	1.2	1.2	1.2	1.3	1.3	1.4	1.5
Less: Refurbishment costs[3]	(0.3)	(0.3)	(0.3)	(0.9)	(0.9)	(0.9)	(0.4)	(0.4)	(0.4)
Interest income[4]	0.3	0.3	0.4	0.4	0.5	0.6	0.6	0.7	0.8
Ending Balance	**$ 6.8**	**$ 7.9**	**$ 9.2**	**$ 9.9**	**$10.7**	**$11.7**	**$13.2**	**$14.9**	**$16.8**

See footnotes at end of appendix.

Appendix O. Estimated Revenues and Furnishing Reserve Fund Activity From FY 1996 Through FY 2020

	FY 2014 (millions)	FY 2015 (millions)	FY 2016 (millions)	FY 2017 (millions)	FY 2018 (millions)	FY 2019 (millions)	FY 2020 (millions)
Revenue	$38.3	$39.9	$41.4	$43.1	$44.8	$46.6	$48.5
Maintenance Fund							
Beginning balance[1]	16.8	18.7	20.0	21.5	23.0	25.5	28.1
From gross revenues[2]	1.5	1.6	1.7	1.7	1.8	1.8	1.9
Less: Refurbishment costs[3]	(0.5)	(1.2)	(1.2)	(1.3)	(0.5)	(0.5)	(0.6)
Interest income[4]	0.9	0.9	1.0	1.1	1.2	1.3	1.5
Ending Balance	**$18.7**	**$20.0**	**$21.5**	**$23.0**	**$25.5**	**$28.1**	**$30.9**

[1]Beginning balance taken from previous year's ending balance in Furnishing Reserve Fund. FY 1995 ending balance in Furnishing Reserve Fund is $0.5 million.

[2]Contribution to Furnishing Reserve fund is 3 percent of gross revenue in FY 1996 and 4 percent in FY 1997 and subsequent years.

[3]Refurbishment costs are based on refurbishment of 5 year items and 10 year items as recommended by the American Hotel and Motel Association.

[4]Interest of 5 percent applied to beginning balance plus contribution less refurbishment cost.

Appendix P. Estimated Costs of Rebuilding Armed Forces Recreation Center-Orlando

Table P-1. Rebuilding Costs

Year	AFRC-Hale Koa Comparative Rebuilding Costs[1] (millions)	AFRC-Orlando Appraisal Rebuilding Costs[2] (millions)
1995	$20.0	$36.0
1996	20.8	37.4
1997	21.6	38.9
1998	22.5	40.5
1999	23.4	42.1
2000	24.3	43.8
2001	25.3	45.6
2002	26.3	47.4
2003	27.4	49.3
2004	28.5	51.2
2005	29.6	53.3
2006	30.8	55.4
2007	32.0	57.6
2008	33.3	59.9
2009	34.6	62.3
2010	36.0	64.8
2011	37.5	67.4
2012	39.0	70.1
2013	40.5	73.0
2014	42.1	75.8
2015	43.8	78.9
2016	45.6	82.0
2017	47.4	85.3
2018	49.3	88.7
2019	51.3	92.3
2020	53.3	96.0

See footnotes at end of appendix.

Table P-2. Financial Capability to Rebuild in Year 2020

	With $ * Room Rate Increase (millions)	Without Room Rate Increase (millions)
Average rebuilding costs[3]	$75.00	$75.00
Maintenance fund balance	31.00	31.00
Cash flow FY 2011 through 2020	46.92	19.85
Surplus/(deficit)[4]	$ 2.92	($24.15)

[1]One of the AFRC hotels that CFSC manages is the Hale Koa hotel in Hawaii. The CFSC plans to do major renovations on the 20-year old original tower in FY 1998. The CFSC current estimate to renovate 416 guest rooms is $28 million; cost per room is $67,308. Applying this to AFRC-Orlando's 287 guest rooms, the cost to renovate AFRC-Orlando would be about $20 million ($67,308 x 287 rooms). If we escalated $20 million by 4 percent a year for inflation, the renovation cost in FY 2020 would be $53 million.

[2]Rebuilding costs with 4 percent inflation based on a 1991 appraised building value of $36 million.

[3]The average rebuilding costs were calculated by adding $53.3 million and $96.0 million and dividing by 2.

[4]The AFRC-Orlando is projected to have $31 million in its Furnishing Reserve fund in FY 2020. Comparing that amount with $75 million of rebuilding cost in FY 2020, AFRC-Orlando will require an additional $44 million in FY 2020 to pay for rebuilding. Therefore, the money in the Furnishing Reserve fund alone will not be enough to pay for rebuilding the hotel. The AFRC-Orlando will generate $19.85 million in cash flow from FY 2011 through FY 2020 even if room rates are only increased for inflation. If FY 1997 room rates are increased by $ * per night in excess of inflation and room rates are increased afterward for inflation, the hotel should generate $46.92 million in cash flow from FY 2011 through FY 2020. The money from the increased cash flow could provide the funds necessary for rebuilding AFRC-Orlando.

*Proprietary data deleted.

Appendix Q. Cash Flow From Armed Forces Recreation Center-Orlando After Provision for Maintenance Fund

Year[2]	Cash Flow at Current Rates Plus Inflation (millions)	Cash Flow with $8 Increase[1] in Room Rates Plus Inflation (millions)	Cash Flow with $ * Increase[1] in Room Rates Plus Inflation (millions)
2011	$ 1.65	$ 2.94	$ 3.91
2012	1.72	3.06	4.06
2013	1.79	3.18	4.23
2014	1.86	3.31	4.39
2015	1.93	3.44	4.57
2016	2.01	3.58	4.75
2017	2.10	3.72	4.94
2018	2.18	3.87	5.14
2019	2.26	4.03	5.35
2020	2.35	4.19	5.56
Total	**$19.85**	**$35.32**	**$46.90**

[1]Room rate increase occurs in FY 1997.

[2]This appendix shows cash flow after the AMWRF loan is paid in full in FY 2010.

*Proprietary data deleted.

Appendix R. Management Comments on the Findings and Audit Response

Finding A. Alternative to the Acquisition and Operation of AFRC-Orlando

Block Reservation of Rooms

Management Comments (see Part IV for complete U.S. Army Community and Family Support Center comments). It is not possible to obtain a steady supply of rooms throughout the year without block-reserving a set number of rooms.

Audit Response. Because AFRC-Orlando has had 96 percent occupancy with 50 percent overflow, there is no reason the Army could not block reserve rooms. Most importantly, the Army Central Reservation Center and Lodging Success Program negotiated 30 percent discounts on commercial hotels. After the initial annual cycles were completed, the requirement to block reserve was amended so that the commercial hotels could rent the rooms to the public if the rooms were not rented 10 days in advance. The requirement to block reserve rooms was deleted from the contract for discounts.

The Army could also pay to reserve 300 rooms a month at $70 a night, and then resell the rooms as people make reservations. Buying 9,000 room nights at $70 a night would cost $630,000 for a month. As rooms are rented, money becomes available to rent the next month of rooms. However, the lost interest on the $ * loan is $ * per year. So, for a fraction of the annual lost interest of $ * , the Army could purchase and resell rooms instead of spending $ * for a hotel and subsidizing the hotel with $ * in lost interest. The Army could buy and resell the rooms as if it were a revolving fund.

By use of a central reservation system, the Army could lower room rental costs for 68 percent of the patrons of AFRC-Orlando who are now paying more than

*Proprietary data deleted.

the commercial rates at Disney operated and other Orlando hotels. In response to three separate communications from us, the Army has never stated why it makes 68 percent of the patrons (Service members) pay more expensive room rates than at Disney and other available hotels. Further, the Army could receive a rate comparable to AFRC-Orlando for the other 32 percent of the patrons.

Economic Value to the Service Members

Management Comments. A central reservation system would financially penalize Service members who would be subject to 11 percent room tax and 6 percent sales tax on food, beverages, and other sales they are presently exempt from.

Audit Response. Because of the cost of AFRC-Orlando, required room rates will be so high after the initial sales pitch period is passed that AFRC-Orlando will penalize Service members. In FY 1996, when rates are scheduled to increase by $6, the category rates increase to an average rate of $75 plus additional miscellaneous charges. However, a commercial hotel within 1 mile of Disney World has a commercial rate of $47 per night including free breakfast. Escalating that hotel's room rate at 4 percent inflation for 2 years and 11 percent for room taxes yields a comparable rate of $56 per night. At a Disney hotel, the commercial rate with taxes is $75.90. On average, the Service member will be penalized $19 a night.

Assessment of Telephone Reservation System

Management Comments. The PKF Consulting independent assessment of a telephone referral system concluded that the current magnitude of referrals is predicated on the presence of AFRC-Orlando. PKF Consulting stated that annual operating expenses of a telephone reservation system would exceed commission revenue by $200,000 the first year.

Audit Response. The independence of a consultant under contract with the Army and paid with the Service members money is not assured. The conclusion that the current magnitude of occupancy and referrals is based on the presence of AFRC-Orlando was based on a nonstatistical sample, and it used questions that biased the results. Even the results of the nonstatistical biased sample did not support a conclusion that 50 percent of the patrons would not have come to Orlando if AFRC-Orlando did not exist.

The PKF Consulting assessment included expenses of $200,000 for maintaining a toll-free telephone number. However, AFRC-Orlando does not have toll-free service. Callers to AFRC-Orlando are paying for the call or using the Army Central Reservation System number to avoid the charges. Using AFRC-Orlando's own actual occupancy rate and budgeted overflow, and using PKF Consulting's estimated expenses (excluding toll-free telephone service), we estimate a profit of $335,347 in the first year of a telephone reservation system. However, the purpose of the telephone reservation system is to provide a benefit to the Service member and the amount of profit and loss is not important, because the investment in a telephone reservation system does not require a hotel's massive loan repayments and maintenance.

Discounts and AFRC-Orlando

Management Comments. Current discounted rates at Disney hotels are a function of AFRC-Orlando's existence.

Audit Response. Hotel industry literature (1995) reports that because of Disney's aggressive hotel expansion program, an oversupply of hotel rooms exists in the Orlando area. Therefore, hotels in the Orlando area do not represent a good investment.

Cost Comparison of Disney's All-Star Inn and AFRC-Orlando

Management Comments. Service members are willing to pay higher rates to attain maximum value for their family vacation. The All-Star Resort offers austere amenities with rooms that are 42 percent smaller than AFRC-Orlando. Many families that are now comfortably accommodated in one guest room at AFRC-Orlando would require two rooms at the All-Star Resort.

Audit Response. The Army has no basis for its statement that Service members are willing to pay more to stay at AFRC-Orlando. The Army does not advertise the benefit of commercial rates or overflow rates to Service members.

Disney's All-Star Resort offers all the amenities of any Walt Disney World Resort hotel, including free cribs (AFRC-Orlando charges for cribs), hair dryers, wheelchairs, and disabled guest kits. The rooms are 260 square feet,

large enough for 2 double beds per room, remote control color television, central air conditioning, and a modern Vingcard 3000 door lock system not available in AFRC-Orlando. Literature distributed by AFRC-Orlando stated that Disney's All-Star Resort offers excellent value-priced accommodations of sports and music themes in a bright fun atmosphere. Of the AFRC-Orlando overflow, 17 percent already chooses the All-Star Resort. The average number of occupants per room night at AFRC-Orlando is 2.8; so, the average families that stay at AFRC-Orlando could also be accommodated at All-Star Resort.

Benefits, Costs, and Business Risks

Management Comments. The Army noted that the PKF Consulting study concluded that the business risk to the Army was quite acceptable. The Army noted benefits to the local Orlando economy from business generated by AFRC-Orlando, and the benefits to the member staying on Walt Disney World.

Audit Response. The benefits of staying at a hotel on Walt Disney World can accrue to the member by staying at the Disney All-Star Resort or another accommodation on Walt Disney World. Paying $ * for AFRC-Orlando, subsidizing the purchase by foregoing $ * in interest, plus downstream maintenance costs of $56.2 million to $90.5 million is not essential to the Service member receiving the benefits of staying on Walt Disney World.

The benefits to the local Orlando economy noted by the Army will accrue even if the Service members stay in commercial hotels.

DoD Policy

Management Comments. DoD Instruction 4100.33 requires DoD to "rely on commercially-available sources to provide commercial products and services except when required for national defense." The Army stated, "This directive is not mandatory for commercial activities staffed solely with DoD civilian personnel paid by nonappropriated funds."

Audit Response. Although DoD Instruction 4100.33 is not mandatory for nonappropriated funds, the establishment of a commercial hotel business does not meet the intent of the DoD instruction to use available commercial

*Proprietary data deleted.

resources. DoD Directive 1015.6, "Funding of Morale, Welfare, and Recreation Programs," requires the head of DoD Components to ensure that the life-cycle cost of MWR facilities to be financed from appropriated or nonappropriated funds is held to a minimum. With the downsizing in DoD, the base closures and the Commission on Roles and Missions recommendations to privatize logistics, finance, and maintenance activities, the Office of the Secretary of Defense and the Army need to consider the public perception of the Army owning a hotel on Walt Disney World Resort.

Finding B. Financial Projections for AFRC-Orlando

Self-Sufficiency

Management Comments. Self-sufficiency is assured once the building and prepayment of land rent are accomplished. Terminating annual rent will generate positive cash flow allowing AFRC-Orlando to contribute $2.7 million annually (1995 value) to HCMF. PKF Consulting stated that IG, DoD, estimates of cash flow are understated, and that AFRC-Orlando can attain an annual occupancy rate of 98 percent. The Army stated that from February through July 1995, while rent expense was $ * , improvements in the reservation system produced an occupancy rate of 99.1 percent. Additionally, reduced operating costs resulted in a $0.2 million positive cash flow. Further, Deloitte and Touche has validated the Army's ability to finance this investment and its other nonappropriated fund priorities.

Audit Response. The statements of the Army and PKF Consulting concerning cash flow are misleading. The net cash flow to the HCMF from the purchase of AFRC-Orlando will be a loss of more than $ * in cash per year. The Army and PKF Consulting cash flow forecasts are not based on generally accepted accounting principles. The Army cash flow forecasts ignore:

o the payment of $ * per year to repay the loan to purchase AFRC-Orlando and

o a required set aside of cash for AFRC-Orlando refurbishment equal to 4 percent of gross revenues ($0.8 million per year from 1997 and accelerating) that will not be available for general purposes.

*Proprietary data deleted.

Appendix K of this report identified weaknesses in the Deloitte and Touche study. The weaknesses are not the fault of Deloitte and Touche because the Army either did not provide them all data needed to make the best analysis or did not ask them to perform some of the analysis we performed. A consultant can only be as good as the data made available. The Army continues to cite the study although it has not responded to the reported weaknesses in the study. Those weaknesses include the self-sustaining criteria and loan payment, capital reinvestment assessment, building depreciation, and long-term maintenance liabilities.

Furnishing Reserve

Management Comments. Current cash flow projections consider all AFRC-Orlando capital expenditures, including furnishings, as a cash outflow. To portray the Furnishing Reserve as an additional outflow overstates AFRC-Orlando's cash obligation.

Audit Response. The required cash set-aside exceeds the budgeted AFRC-Orlando capital expenditures, including furnishings. The IG, DoD, treated budgeted expenditures as an obligation of the Furnishing Reserve. The failure of the Army to recognize the requirement to set aside cash in a Furnishing Reserve overstates cash available for general purposes. Also, the required set-aside escalates by 1 percent per year the first 4 years until it reaches 4 percent per year. The initial low rates required for maintenance set-aside are incentive rates. After AFRC-Orlando is purchased the required set-asides for maintenance will increase to levels closer to the amount needed.

Cash Management Philosophy

Management Comments. There are fundamental philosophical differences in the manner in which the Army manages cash and in the IG, DoD, opinion of how the Army should manage cash. Army policy permits cross-leveling funds between NAFIs. Cross-leveling allows the pooling of cash to fund the most urgent requirements on a wide level, rather than waiting for the individual activity to generate sufficient funds. In that way, cash is put to use in the most efficient manner. That was the genesis of establishing the HCMF.

Audit Response. We have no disagreement with the Army pooling excess NAFI cash to fund additional NAFI activity. However, the cross-leveling of

funds establishes the other AFRCs as subsidies of AFRC-Orlando. When the Army MWR Board approved the acquisition of AFRC-Orlando, the maintenance budgets of the other AFRCs were reduced by 25 percent. Such reductions will only lead to higher maintenance costs later and will possibly lower occupancy rates at the other AFRCs.

Interest Free Loan Subsidy

Management Comments. According to the Army, the audit contended that if the AMWRF does not receive 7 percent interest on its $ * cash advance, Army NAFIs will contribute a $ * subsidy to the purchase of AFRC-Orlando over that 14-year repayment period. It is the policy of the Army that cash advances between Army NAFIs will be repaid without interest. The Army uses its cash for the benefit of its soldiers and their families, not simply to earn interest.

Audit Response. In accordance with Army regulation, ABIF was established as a place where all the Army NAFIs could pool their money to earn the highest rate of interest in a secure depository. All Army NAFI funds are required to be deposited in the ABIF. Those funds are loaned to AMWRF for AFRC-Orlando, interest free; and interest does not accrue on those funds to the Army NAFI depositors. The ABIF interest-free loan is inconsistent with the Army regulation that established ABIF. If interest were charged, the $ * could be added to morale funds available for Service members at all Army bases. We used the $ * to show the true cost of purchasing AFRC-Orlando for Service members.

Finding C. Maintenance Requirements

Maintenance and Capital Investment Requirements

Management Comments. Major renovations and construction are major capital expenditures funded from HQDA-level NAFIs, and normally require DoD and congressional approval. A programmed maintenance and replacement plan often mitigates the requirement of major renovations.

*Proprietary data deleted.

Audit Response. The agreement with Disney requires the Army to maintain AFRC-Orlando to Disney standards for 100 years or reimburse Disney for the cost of repairs. Unlike the other AFRCs, congressional and DoD approval are not required for Disney to maintain AFRC-Orlando and bill the Army.

Programmed maintenance will not change the wear and tear on a hotel or the effects of weather and other factors over time. Major renovations in phases should be planned and programmed with funds. The negative cash flow of the AFRCs from 1997 through 2010, due to the loan payments for AFRC-Orlando, could preclude fund availability for phased renovation or maintenance at AFRCs until after the year 2010. By 2020, major renovations of AFRC-Orlando will be required. For example, the 20-year old tower at the Hale Koa, now requires a major renovation at a cost of $28 million, because not enough maintenance was performed during the preceding two decades.

Reserve Fund Requirements

Management Comments. The Palm Hospitality Company confirmed that the Army is in full compliance with repair and maintenance requirements of the lease. Operating and cash flow projections, as verified by PKF Consulting, indicate that the Army will have more than sufficient resources to maintain the property's superior condition. The Furnishing Reserve fund, required by the lease, is but one source of funds available for this purpose.

Audit Response. We reported that the Army was in violation of the terms of the lease because it was not depositing sufficient funds into the Furnishing Reserve. Palm Hospitality Company and Disney may view differently violations of the agreement after the payment of $ * . AFRC-Orlando is in excellent condition. Over time, substantial maintenance and renovation will be required. AFRC-Orlando will not have money for phased renovation until the loan for the purchase is repaid in the year 2010, unless room rates are increased, more appropriation subsidies are received for the AFRCs in Europe or Korea or the maintenance budget requirements of the other AFRCs are reduced to subsidize AFRC-Orlando.

Ongoing Maintenance and 25-Year Cycle

Management Comments. PKF Consulting verified that the Army plan to refurbish rooms over time can be accomplished while achieving a projected

*Proprietary data deleted.

occupancy rate of 98 percent. The review further identified the commonly accepted industry standard for hotel refurbishment as a 25-year cycle.

Audit Response. We identified errors in the PKF Consulting calculations. However the PKF consulting study and IG, DoD, numbers are essentially the same except that PKF Consulting reduced maintenance costs to FY 1995 dollars (reduces the amount) and we escalated maintenance costs to FY 2020. We also took the corrected 1995 value of major repairs identified by PKF Consulting ($21.1 million corrected) and escalated the cost to the year 2020, at rates of 4, 5, and 6 percent. We estimated that the range of major renovation cost was from a low of $56.2 million, to a mid-point of $71.4 million, to a high of $90.5 million. The PKF Consulting study verified our original estimates. We agree with a 25-year cycle. However, the Army and PKF Consulting have not recognized that the hotel is in years 26 through 50 of a cycle, and functional obsolescence is a reality.

Real Projected Maintenance Requirement

Management Comments. The AFRC-Orlando can maintain its condition and avoid massive unprogrammed capital investments by performing cyclical repairs totaling $20.8 million (1995 value dollars) over 25 years versus the $75 million figure suggested by the IG, DoD, at year 2020.

Audit Response. The Army reported projected requirement of $20.8 million is misleading to an uninformed reader. It represents the estimated 25-year costs of maintaining AFRC-Orlando discounted at 3 percent to 1995 dollars. Actually, $21.1 million is the correct base figure for 1995. When the $21.1 million in 1995 dollars is escalated at inflation rates of 4, 5, and 6 percent to the year 2020, the range is from $56.2 million to $90.5 million with a mid-point of $71.4 million. This verifies our original $75 million estimate of the cost of major renovation in the year 2020.

Appendix S. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and Type of Benefit
A.1. and A.2.	Economy and efficiency. Prevents inefficient use of Army MWR funds.	Nonappropriated Funds put to better use of $ * if purchase is not approved.
B.1. and B.2.a.	Economy and efficiency. Provides reasonable basis for financial planning and decisionmaking.	Nonmonetary.
B.2.b.	Compliance. Allows AFRC-Orlando to be self-sustaining.	Undeterminable. The amount of funds put to better use depends on future actions.
C.1.	Compliance. Provides plan for fulfilling lease requirements.	Nonmonetary.
C.2.	Compliance. Allows AFRC-Orlando to be self-sustaining.	Undeterminable. Funds for renovation or rebuilding cannot be accurately estimated.

*Proprietary data deleted.

Appendix T. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Personnel and Readiness), Washington, DC
Under Secretary of Defense (Policy), Washington, DC
Assistant Secretary of Defense (Economic Security), Washington, DC

Department of the Army

Assistant Secretary of the Army (Manpower and Reserve Affairs), Washington, DC
Assistant Chief of Staff (Installation Management), Washington, DC
Army Community and Family Support Center, Alexandria, VA
 Armed Forces Recreation Center, Orlando, FL

Non-Government Organizations

American Hotel and Motel Association, Washington, DC
Deloitte and Touche Certified Public Accountants, Washington, DC
Hospitality Valuation Services, Inc., Mineola, NY
Palm Hospitality Company, Orlando, FL

Appendix U. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Under Secretary of Defense (Personnel and Readiness)
Under Secretary of Defense (Policy)
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Commander, U.S. Army Community and Family Support Center
  General Manager, Armed Forces Recreation Center-Orlando
Auditor General, Department of the Army
Assistant Secretary of the Army (Manpower and Reserve Affairs)

Department of the Navy

Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency

Non-Defense Federal Organizations

Office of Management and Budget
National Security and International Affairs Division, General Accounting Office
Technical Information Center
Defense and National Aeronautics and Space Administration Issues
Military Operations and Capabilities Issues

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security
House Committee on National Security, Panel on Morale, Welfare, and Recreation

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Part III - Management Comments

Department of the Army Comments

DEPARTMENT OF THE ARMY
U.S. ARMY COMMUNITY AND FAMILY SUPPORT CENTER
ALEXANDRIA, VA 22331-05

REPLY TO ATTENTION OF

August 29, 1995

MEMORANDUM THRU ASSISTANT CHIEF OF STAFF FOR INSTALLATION MANAGEMENT
~~DIRECTOR OF THE ARMY STAFF~~
ASSISTANT SECRETARY OF THE ARMY (MANPOWER AND RES~~ERVE AFFAIRS)~~

FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE (LOGISTIC SUPPORT)

SUBJECT: Army Response to Draft Audit Report Project No. 5LA-5040, Audit of the Armed Forces Recreation Center-Orlando, August 17, 1995--INFORMATION MEMORANDUM

The AFRC-Orlando is overwhelmingly popular with members of the Department of Defense (DoD). It has attained levels of occupancy unprecedented for newly established commercial hotels. Customer demand is evidenced by the fact that the occupancy rate is more than 25 percentage points higher than the national hotel average. As overwhelming demand has exceeded AFRC-Orlando's available room nights, customers have been referred to local hotels in numbers equal to 50 percent of AFRC-Orlando's annual capacity.

Since January 1995 when Report No. 95-087 was issued, AFRC-Orlando's operating results have improved dramatically. Monthly occupancy rates have averaged more than 99 percent and management efficiencies have resulted in positive cash flow for the past 6-month period. Patron demand and AFRC-Orlando's self-sufficiency (assuming elimination of rent expense) have been verified.

The Army is absolutely committed to enhancing the quality of life for servicemembers and their families through balanced morale, welfare, and recreation (MWR) programs. Armed Forces Recreation Centers are essential components of MWR. The Army can afford the required nonappropriated fund (NAF) investment to purchase the AFRC-Orlando building, prepay land rent for the existing lease term, and remains convinced that this is a prudent investment of soldiers' dollars. Deloitte & Touche, a "Big Six" accounting firm, has validated the Army's ability to finance this investment and its other NAF priorities. The Army's detailed response is at enclosure 1.

CFSC-HD
SUBJECT: Army Response to Draft Audit Report Project No. 5LA-5040, Audit of the Armed Forces Recreation Center-Orlando, August 17, 1995--INFORMATION MEMORANDUM

AFRC-Orlando will provide a significant benefit for soldiers, sailors, airmen, and marines and will be financially self-sustaining. The Army's conclusions are corroborated by the analysis at enclosure 2 conducted by Pannell Kerr Forster Consulting, Inc., the hospitality industry's largest international consulting firm, and the letter at Annex A of our response, from Mr. Al Weiss, Executive Vice President, Walt Disney World, confirms that the alternative of a referral reservation system will not accomplish the mission.

The Army continues to strongly support its previous decision to seek formal Department of Defense and Congressional approvals for the purchase of the building and prepayment of land rent in September 1995.

JOHN G. MEYER, JR.
Brigadier General, USA
Commanding

Enclosures *
as

* The review by Pannell Kerr Forster Consulting, Incorporated was not enclosed with the management comments in this final report because its inclusion would conflict with Office of Management and Budget, Office of Federal Procurement Policy (OFPP) Letter 92-1. The policy letter states that "... contractors are not to be used for the drafting of ... agency responses to audit reports from an Inspector General." The OMB policy is that drafting of responses to audit reports from an Inspector General is an inherently governmental function.

Mr. Isaacs/CFSC-HD/325-9500

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August 29, 1995

Army Response to DoDIG Draft Audit Project 5LA-5040
Armed Forces Recreation Center-Orlando
August 17, 1995

Finding A. Alternative to the Acquisition and Operation of Armed Forces Recreation Center-Orlando (AFRC-O): The U.S. Army Community and Family Support Center (USACFSC) did not effectively analyze and evaluate a possible alternative to the acquisition and operation of AFRC-O. The condition occurred because USACFSC did not consider the operation of a central reservation system as an alternative that would allow terminating the lease for AFRC-O. As a result, the cost of $ * and the business risks involved in acquiring AFRC-O were higher than if hotel services were procured from commercially available sources for preferred rates through a central reservation system. In addition, financial projections (Finding B) show that AFRC-O costs of $27.2 million and long-term maintenance requirements (Finding C) of $44 million need to be subsidized by the other AFRCs.

Additional Facts Provided by Army:

DoD Policy on Recreational Activities and Services, page 4 of Draft Audit Report:

The report contends Department of Defense Instruction (DoDI) 4100.33 requires DoD to "rely on commercially-available sources to provide commercial products and services, except when required for national defense." Paragraph B-3 of DoDI 4100.33 states, "This directive is not mandatory for commercial activities staffed solely with DoD civilian personnel paid by nonappropriated funds." AFRC-O is a Category C, morale, welfare, and recreation (MWR) activity staffed entirely by nonappropriated fund (NAF) personnel. This activity fully complies with the spirit and intent of the DoD Directive 4100.15 and DoD Instruction 4100.33; therefore, DoDIG should either delete reference to these documents in their final report or state Army is in compliance with OSD policy.

AFRCs have long been recognized as critical components of a well-rounded MWR system. The United States Senate praised establishment of AFRC-O in the following language of the Senate Report on the National Defense Authorization Act for fiscal year 1995, "The committee commends the Department of Defense and Department of the Army for establishment of Shades of Green, the first armed forces recreation center in the continental United States. This endeavor represents the finest tradition of the military taking care of its own at no cost to the American taxpayer. The U.S. Army Community and Family Support Center has demonstrated keen foresight in positioning this morale building benefit for a defense force that will be increasingly based in the

ENCL-1

*Proprietary data deleted.

August 29, 1995

United States, and displayed great tenacity in pursuing a quality recreation opportunity for all ranks, especially junior grades."

Use of Central Reservation System, page 5 of Draft Audit Report:

The audit contends" CFSC did not effectively analyze and evaluate all other alternatives to the acquisition and operation of AFRC-O such as the operation of a central reservation system." In fact, this alternative and many others were fully examined during the evaluation phase of the AFRC-O initiative. It is possible to obtain agreements for hotel referrals at rates less than published rack rates in some Orlando area hotels. However, the degree of discount and availability is dictated by seasonal demand and prevailing economic conditions. It is not possible to obtain a steady supply of rooms throughout the year without block-reserving a set number of rooms. To negotiate under these circumstances, the Army would also have to guarantee the property owner the negotiated price per room, whether occupied or not. Absent AFRC-O there would be no incentive for other properties to offer discounted rates comparable to the AFRC-O rate structure. Further, AFRC-O is on Walt Disney World® Resort and it may not always be possible to contract for rooms on Walt Disney World® (Annex A).

The Army has successfully negotiated acceptable rates in Washington, D.C. and other locations for its central reservation system. However, there is no comparison between those hotels and a full-service destination resort such as AFRC-O. The hotels participating in the Army's central reservation system are primarily for official duty travelers. The Army is able to negotiate acceptable rates with these hotels because their occupancy levels are much lower than those of quality, resort hotels in Orlando. In return for the discounted room rates, the hotels are assured higher occupancy and, therefore, increased revenues.

A central reservation system would financially penalize servicemembers as they would be subject to the 11 percent room tax and 6 percent sales tax on food, beverages, and other sales from which they are presently exempt at AFRC-O.

The draft report states, "A central reservation system already exists at AFRC-Orlando. The reservation office is located in structures built by CFSC behind Shades of Green. The AFRC-Orlando central reservation system . . . earned commissions of $31,775 in February 1995 and had expenses of $19,892, leaving a profit of $11,883 in one month." The likelihood of replicating these financial results with a stand-alone central reservation system is minimal, since:

- Without the demand generated by AFRC-O, the pull of Orlando will not be sufficient to support the operating costs of a central reservation system. AFRC-O has created demand among the DoD customer base that did not exist before

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its establishment. Our customers' first preference is AFRC-O; referrals occur only if AFRC-O is unable to accommodate potential customers.

- The DoDIG financial projections do not consider the separate overhead support system (management, communication, postage, marketing, accounting, human resources, procurement, and so on) costs. In the current AFRC-O operations, these functions are performed by, and their costs charged among, operating departments which greatly reduces departmental pro rata cost.

An independent assessment of a telephone referral system conducted by Pannell Kerr Forster (PKF) Consulting, Inc., the leading hospitality industry authority, concludes:

- AFRC-O is the first preference of the vast majority of patrons.
- Current magnitude of referrals is predicated on the demand generated by the presence of AFRC-O. Without AFRC-O demand would decline and by year three demand would be insignificant.
- AFRC-O is the focal point for DoD visitors to Orlando, providing a sense of community and home base, even for those staying elsewhere.
- Absent AFRC-O, other Orlando properties would have no incentive to offer discounted rates comparable to those at AFRC-O. Current discounted rates at Disney hotels are a function of AFRC-O's existence. These rates are offered on a space-available basis and would not be available absent AFRC-O.
- If the Army were able to refer 50 percent of AFRC-O's current annual occupancy and 100 percent of current referrals using a central reservation system, annual operating expenses of system would exceed room commission revenue by $200,000 in the first year. Commission revenue would rapidly decline, and the operating loss increase accordingly, as demand would rapidly diminish over time. PKF warns that its first year revenue projections are highly optimistic, as patrons would not enjoy current tax exemptions nor the social comradery and market affinity associated with AFRCs.
- AFRC-O offers a special vacation opportunity in terms of service, facility, ambiance of location, and price/value relationship that would be impossible to duplicate. Absent AFRC-O as a demand stimulus, the "customer experience" of being booked in a budget-type hotel would not foster future reservation demand.

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Cost Comparison of an Alternative to Buying AFRC-Orlando, page 6 of Draft Audit Report:

It is true that there are room rates available in Orlando that are lower than those at AFRC-O. The negotiated pretax rate at the All-Star Resort is equal to the lowest rate available at AFRC-O. However, USACFSC does not agree that a price/value comparison of an AFRC-O vacation experience and an All-Star Resort vacation experience will yield equal results. Servicemembers are willing to pay higher rates to attain maximum value for their family vacation. They recognize the difference between an economy lodge and a quality resort. The All-Star Resort is not a comparable property. It is an economy lodge, offering austere amenities and rooms that are 42 percent smaller than AFRC-O's. Many families that are now comfortably accommodated in one guestroom at AFRC-O would require two rooms at the All-Star Resort.

AFRC-O is the customers' overwhelming first choice. The occupancy rate from grand opening in February 1994 through July 1995 averaged 95.5 percent. From February 1995 through July 1995 the occupancy rate increased to an average of 99.1 percent as a result of improvements in our reservations process. Thousands of customers have opted to be put on AFRC-O's wait-list and thousands more have decided not to come to Orlando at all because AFRC-O rooms were not available. The customers' second choice is referral to a variety of Walt Disney World® Resort hotels ranging from $54 (with tax) at the All-Star to $121 (with tax) at the Yacht and Beach Club. While some AFRC-O customers are price-sensitive, their primary considerations are location and convenience to the attractions, as cited in the PKF report. Of those who opted for referral, only 17 percent chose the economy All-Star Resort.

The report cites that, "The adverse results of room rate comparisons are due in part to the purchase price of AFRC-Orlando. The $ * purchase price for a hotel with 287 rooms equals $ * per room. In 1993, another quality hotel in Orlando sold for $48,000 per room." This comparison is inappropriate as discussed below: Deleted

- The hotel cited as selling for $48,000 per guestroom is the Radisson Plaza Hotel in downtown Orlando. This property is not a comparable to AFRC-O. The Radisson Plaza is 19 miles from Walt Disney World® Resort (40 to 100 minutes driving time, depending on traffic) and was developed as a business traveler/ convention hotel, not a destination resort. The PKF report reveals:
  - The Radisson Plaza is a 336-guestroom hotel with 18,000 square feet of meeting space on a 1.7 acre site in downtown Orlando. It occupies space virtually sidewalk-to-sidewalk with no grounds or recreation facilities other than a swimming pool.

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*Proprietary data deleted.

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- It was developed in 1985 at a cost of $32-$35 million.
- The Radisson Plaza had $28 million of mortgage debt.
- By 1993 it was a financially distressed property that had deferred capital investments required to maintain property quality due to lack of revenue.
- The the savings and loan that was holding the mortgage went bankrupt and was taken over by the Federally-chartered Resolution Trust Corporation (RTC).
- This distressed property was sold at an RTC auction in December 1993 for $16 million ($48,000 per guestroom) despite having a $28 million mortgage.
- The $12 million ($35,700 per guestroom) difference between the mortgage amount and sale price was absorbed by Federal and State Governments, their respective deposit insurance organizations, and by depositors and/or investors in the failed savings and loan institution.
- The purchaser would have to invest $8 million ($23,900 per guestroom) to return the property to a reasonable physical condition.
- The $ * per-guestroom cost for AFRC-O is squarely in the market range when compared to per-guestroom prices of recently purchased successful quality resort hotels in Florida. Examples include: the Reach Resort in Key West, $128,333; the Hyatt Grand Cypress near Walt Disney World® Resort, $213,333; and the Grand Bay in Coconut Grove, $151,934.

Benefits, Costs, and Business Risks, page 8 of Draft Audit Report:

Page 8

The report argues that benefits derived from purchasing Shades of Green do not justify the cost and business risks of making this investment. The report ignores the fact that, should the lease agreement be terminated by either party, the Army will receive the unamortized value of the investment, based on a 100-year term. This mitigates the investment risk. The report also ignores the fact that a comprehensive study by Deloitte & Touche in June 1995 concluded that the business risk to the Army was quite acceptable.

The report fails to weigh the relative merits of the proposed central reservation system versus AFRC-O. It extrapolates an incomplete analysis of the financial viability of the

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*Proprietary data deleted.

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proposed reservation system by failing to consider the overhead structure as discussed above. The report also fails to consider with any scientific methodology what the military customer wants, or perceives as a true benefit of service.

The AFRC-O initiative complies with the principles of the National Performance Review/Defense Performance Review and public statements from the Under Secretary of Defense (Personnel and Readiness) and Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education) in support of partnerships with communities in delivering MWR programs. The Army entered a partnership with Palm Hospitality Company which gives AFRC-O guests direct access to more than 43 square miles of a community (Disney World®) larger than San Francisco. This partnership complies with public and OSD policy and is in consonance with the future direction of MWR. The report also fails to consider the $8.7 million in contracts with local businesses, $14 million annual new sales revenue to Orlando, 287 additional jobs, and 41,000 room nights referred.

The report overlooks the customer experience enjoyed by AFRC-O patrons and the unique benefits offered by this property as outlined in the Army response. The following benefits achieved by staying on Walt Disney World® Resort must also be considered:

- Guaranteed admission to Disney attractions even on the parks' most popular days.
- Exclusive early admission to the theme parks.
- Free parking, a $6 savings per day per park.
- Avoidance of drive time to and from the Disney Resort from off-property hotels in traffic-congested tourist districts.
- Unlimited free use of Disney transportation.
- Convenience and savings (parking, gas, time) of a nearby room for naps, change of clothing, etc.
- Access to Disney dining facilities featuring Disney characters.
- Exclusive advance reservations at Disney restaurants and shows.

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- Preferred golf rates and tee times.

- Access to child-care services.

The report contends AFRC-O possesses a significant business risk, but fails to provide a vulnerability assessment of that risk.

DoDIG	**Army Risk Assessment**
Disney Terminates Agreement	Very low, revenue stream to Disney continues to be advantageous.
Disney World Loses Commercial Appeal	Very low, number 1 resort in America and expanding.
Natural Disaster	Low; AMWRF and Risk Management Program manage this risk for all Army NAFIs.
Hotel Technical Obsolescence	Low; meets Disney and exceeds industry average standards.
Deployment of Patrons	Relatively low; proportion of deployed patrons is small compared to total eligible market.
Energy Crisis	Minimal; current energy market is glutted. Marketing incentives could offset disruption of supply.

DoDIG Recommendation A-1: We recommend that the Under Secretary of Defense (Personnel and Readiness) not approve the purchase of the AFRC-O and direct the USACFSC to use its central reservation system for booking of servicemembers in the Orlando area.

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Army Response: Nonconcur.

Disagree with both recommended actions. Army recommends OSD approve the purchase.

DoDIG Recommendation A-2. We recommend that the Commander, USACFSC:

a. Negotiate hotel discounts and use the established central reservation system or relocate the system to a new site instead of exercising the option to purchase the hotel and prepay the land rent at AFRC-O.

Army Response: Nonconcur.

A-2a. This option disadvantages soldiers by increasing price, fails to equal the perceived benefit, and would lose money indefinitely. There is insufficient customer demand or advantage to support this type of MWR service. This recommendation fails to recognize DoD's mission to improve quality of life of servicemembers. It fails to recognize the benefits derived from providing a premium resort at an affordable price, on the most popular vacation destination resort in the world.

DoDIG Recommendation A-2. We recommend that the Commander, USACFSC:

b. Terminate the lease for the AFRC-O.

Army Response: Nonconcur.

A-2b. The Army intends to pursue obtaining approval to execute the purchase option and prepay land rent.

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Finding B. Financial Projections for AFRC-O: The AFRC-O was not financially self-sustaining The condition occurred because USACFSC established Shades of Green room rates at financially unsupportable levels with inaccurately projected results of operations and cash flow. As a result. USACFSC will divert from other AFRCs the additional cash funds ($27.2 million) required to sustain operations and meet obligations of AFRC-O. Further. the Army personnel at all other installations will be subsidizing AFRC-O with $20.5 million in unearned interest for the Army nonappropriated funds.

Additional Facts Provided by Army:

Page 12

Approval to Open AFRC-Orlando, page 9 of the Draft Audit Report:

Approval to establish AFRC-O was predicated on validating patron demand and demonstrating self-sufficiency through purchasing the building and prepaying the land rent for the entire 100-year lease. Original patronage expectations were that 70 percent of our room nights would be sold at the highest rate categories and 30 percent at the two lowest categories. Actual occupancy has been only 38 percent at the high rates and 62 percent at the lower rates. As room rates are tiered by grade, the unprecedented use by junior ranks has resulted in shortfalls in projected revenue. Despite this fact. patron demand is validated, and self-sufficiency is assured once the building and prepayment of land rent are accomplished.

Page 12

Financial Projections for AFRC-Orlando, page 9 of the Draft Audit Report:

For the first 18 months of operation (February 1994-July 1995). AFRC-O paid $ * in building and land rent. had an aggregate 95.5 percent occupancy rate. and negative cash flow of $.9 million. In the past 6 months (February 1995-July 1995). while rent expense has been $ * . improvements in the reservation system have produced an occupancy rate of 99.1 percent. and reduced operating costs have resulted in a $.2 million positive cash flow. AFRC-O produced $3.0 million positive cash flow before rent expenses since opening. Terminating annual rent will generate positive cash flow allowing AFRC-O to contribute $ * annually (1995 value dollars) to the HCMF.

Cash Flow, page 10 of the Draft Audit Report:

Page 13

The DoDIG's estimated annual cash flow projections through fiscal year 2020 is understated. Independent analysis by Pannell Kerr Forster Consulting. Inc. concludes:

- AFRC-O annual occupancy projections of 98 percent are attainable.

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*Proprietary data deleted.

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- AFRC-O, without rent expense, can be expected to generate $2.7 million (1995 value dollars) annually. It will therefore, generate $65.8 million positive cash flow in fiscal years 1996 through 2020, which more than meets AFRC-O obligations.

Cash Flow and Loan Payment, page 10 of the Draft Audit Report: Page 13

The DoDIG also states AFRC-O will not generate sufficient cash to fund capital improvements and repay the Army Morale, Welfare, and Recreation Fund (AMWRF) cash advance of $ * AFRC-O is one of four operating components of the Hospitality Cash Management Fund (HCMF). The HCMF aggregates profits from all AFRCs and centrally funds prioritized capital improvements and other financial obligations of AFRCs. In addition, the HCMF provides all AFRCs an opportunity to consolidated major asset acquisitions thereby reducing costs and providing more working capital for the individual properties. The Army's funding plan will advance $ * from the AMWRF to the HCMF to fund the purchase option. The HCMF will repay the AMWRF advance at the rate of $ * annually for 14 years. By designating the HCMF as the repayment source, the AMWRF can recover its investment faster than it could if AFRC-O were so designated. Because AFRC-O will continue to contribute $2.7 million annually (1995 value dollars) to the HCMF in perpetuity after year 14 until year 100, AFRC-O will more than pay completely for itself.

AFRCs are operated for the benefit of DoD personnel worldwide. Since AFRC's customer base is mobile and constantly changing, there is no requirement for AFRC-O unilaterally to bear the repayment cost from its own revenues. A previous independent analysis concludes that the HCMF will generate sufficient funds to repay the advance, finance the required capital improvements, and meet the financial needs of the other three AFRCs.

Cash Flow and Long-term Maintenance, page 10 of the Draft Audit Report: Page 13

The discussion of financing the maintenance requirements is the subject of Finding C and Army facts and responses are shown there.

CFSC Financial Projections for AFRC-Orlando, page 10 of the Draft Audit Report. Page 13

Net Income, page 11 of the Draft Audit Report: Page 14

The DoDIG states net income for fiscal year 1996 is overstated by $1.8 million. They state that occupancy is overestimated by 2 percentage points: depreciation expense is disregarded. Capital Reinvestment Assessment (CRA) is not included; and the cost of the commercial audit was not considered in Army projections. Amendments to the

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*Proprietary data deleted.

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reservation policy have resulted in a 99 percent occupancy rate for the past 6 months. The CRA and depreciation are included in current Army profitability projections. For management control purposes, CFSC bears the cost of commercial audits for all AFRCs. The revised AFRC-O fiscal year 1996 operating budget, projecting $2.7 million positive cash flow, is synopsized at Annex B.

Page 14

Cash Flow, page 11 of the Draft Audit Report:

DoDIG contends USACFSC, "did not consider that AFRC-O was obligated by terms of the agreement with Palm Hospitality Company to put $0.5 million in an interest-bearing bank account for maintenance." The contention is based on the lease obligation to set aside AFRC-O cash to replace furnishings (Furnishing Reserve). Current cash flow projections consider all AFRC-O capital expenditures including furnishings as a cash outflow. To portray the Furnishing Reserve as an additional outflow overstates AFRC-O's cash obligation.

The chart at Annex C depicts the financial effects of varying occupancy rates below the 98 percent baseline. At 90 percent occupancy, AFRC-O will still generate $1.8 million positive cash flow. The computed break-even occupancy rate is 73.8 percent. AFRC-O, like all Army NAFIs, is managed and judged on cash produced, measured as net income before depreciation.

Page 14

Paying for AFRC-Orlando, page 11 of the Draft Audit Report.

Page 14

AMWRF Loan, page 11 of the Draft Audit Report:

See Cash Flow and Loan Payment above. There are fundamental philosophical differences in the manner in which the Army manages cash and DoDIG's opinion as to how the Army should manage cash. Army policy permits cross-leveling funds between NAFIs. Cross-leveling allows the pooling of cash to fund the most urgent requirements on a wide level, rather than waiting for the individual activity to generate sufficient funds. In this way, cash is put to use in the most efficient manner. This was the genesis of establishing the HCMF.

Page 15

Subsidy from Other AFRCs, page 11 of the Draft Audit Report:

See the discussion immediately above.

Page15

Limiting the Subsidy, page 12 of the Draft Audit Report:

See the discussion regarding AMWRF Loan.

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Interest-Free Loan Subsidy, page 12 of the Draft Audit Report: Page 16

The audit contends that if the AMWRF does not receive 7 percent interest on its $ * cash advance, that Army NAFIs will make a $ * subsidy to the purchase of AFRC-O over that 14-year repayment period. It is the Army's policy that cash advances between Army NAFIs will be repaid without interest. The Army uses its cash for the benefit of its soldiers and their families, not simply to earn interest. No Army NAF priority or project will be delayed or canceled as a result of AFRC-O's funding strategy. AFRC-O is available to all members of the Army.

Present Value of AFRC-Orlando, page 13 of the Draft Audit Report: Page 17

The DoDIG contends AFRC-O is not a good investment because it is unable to produce a discounted net cash flow equal to the $ * advanced from the AMWRF for its purchase. This contention fails to recognize that cash flow from this operation will continue beyond fiscal year 2010. We fully anticipate operating for the entire 100-year term. Our net present value analysis results in a positive internal rate of return of 6.13 percent based on an investment of $ *

Patrons of AFRC-Orlando, page 13 of the Draft Audit Report: Page 17

The DoDIG further contends that each year approximately 1 percent of the active duty military force will use AFRC-O and that 45 percent of total occupancy will be other than active duty members and their families. The report concludes that soldiers' dollars should not be used to subsidize morale activities for others. There is no Army or DoD standard specifying active duty usage as a condition of approval of MWR projects. The Army views its total force as including active duty members, reserve components, military retirees, and its civilian work force. All components are necessary to field an effective Army and all are worthy and deserving of morale supporting activities. The cash that will be used to purchase AFRC-O was generated by soldiers, retirees, reservists, and civilians at MWR activities of all kinds around the world, including the other AFRCs.

DoDIG Recommendation B-1: We recommend that the Under Secretary of Defense (Personnel and Readiness) use alternative projections, as discussed in this report, of results of operations and cash flow for AFRC-O in the decision to terminate the purchase.

Army Response: Nonconcur.

Army believes, as verified by PKF, that the alternative projections are wrong.

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*Proprietary data deleted.

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DoDIG Recommendation B-2: We recommend that the Commander, USACFSC:

a. Revise projections of operations and cash flow of AFRC-O to reflect depreciation, refurbishment depreciation, capital reinvestment assessment, required deposits to the maintenance fund, and room rental income based on experience and reservations

Army Response: Partially concur.

B-2a. The fiscal year 1996 budget includes depreciation, refurbishment depreciation, capital reinvestment assessment, and room rental income based on experience and reservations. Deposits to the maintenance fund, however, are balance sheet transactions rather than operating expenses.

DoDIG Recommendation B-2:

B-2b. Contingent upon approval of the purchase of AFRC-O, raise room rates in fiscal year 1997 by the lesser of an increase to the ceiling rate or by at least $* in excess of inflation.

Army Response: Partially Concur.

B-2b. AFRC-O room rates will increase by 8.3 percent effective 1 October 1995. That will produce a $5.99 increase in the average daily rate. It is premature to determine room rate requirements for fiscal year 1997. Room rates are based on financial requirements.

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*Proprietary data deleted.

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Finding C. Maintenance Requirements: The AFRC-O did not program for long-term maintenance liabilities to maintain all aspects of Shades of Green to Disney standards. The condition occurred because CFSC had not developed a long-term maintenance plan for AFRC-O and the financial means to support such a plan. As a result, AFRC-O was projected to have $75 million in rebuilding costs but only $31 million in the Furnishing Reserve fund in fiscal year 2020 to pay for major renovation costs. Further, CFSC must use cash flow from other AFRC hotels to pay unfunded long-term maintenance liabilities of AFRC-O.

Additional Facts Provided by Army:

The AFRC-O manages three distinct levels of facility maintenance and improvements. The first level, general day-to-day maintenance (repairing toilets, landscaping, touch-up painting, preventive maintenance and service contracts for mechanical equipment) are recurring operating expenses funded from AFRC-O's operating budget. The second level, programmed repairs and replacements (replacement of kitchen equipment and guestroom furnishings, vehicles) are capital expenditures. A programmed maintenance and replacement plan often mitigates the requirement of major renovations. The third level, major renovations and/or construction (facility expansions, parking lots, total facility rehabilitation), are major capital expenditures funded from HQDA-level NAFIs, and they normally require DoD and Congressional approval. The PKF report supports this policy.

An independent assessment of repair and maintenance and capital investments requirements conducted by Pannell Kerr Forster Consulting, Inc., concludes:

- Repair and maintenance costs are annual operating expenses funded from current year revenues.
- Since opening in February 1994 AFRC-O has been spending and continues to budget for annual repairs and maintenance expenses of $3,316 per guestroom, which exceeds the industry average and is sufficient to maintain AFRC-O in the desired superior condition.

Reserve Fund Requirements, Page 15 of the Draft Audit Report: Page 21

The letter from Palm Hospitality Company confirms that the Army is in full compliance with repair and maintenance requirements of the lease. Operating and cash flow projections, as verified by PKF, indicate that the Army will have more than sufficient resources to maintain the property's superior condition. The Furnishing Reserve fund, required by the lease, is but one source of funds available for this purpose.

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Page 22 **Long-term Maintenance Plan, page 15 of the Draft Audit Report:**

DoDIG suggests AFRC-O has no plans to provide funding for long-term maintenance. PKF states repair and maintenance costs are annual operating expenses funded from current year revenues. PKF further verified that AFRC-O will produce sufficient cash flow for long-term maintenance requirements.

Page 22 **Ongoing Maintenance at AFRC-Orlando, page 16 of the Draft Audit Report:**

The PKF review verified that the Army plan to refurbish rooms over time can be accomplished while achieving the projected occupancy rate of 98 percent. The review further identified that the commonly accepted industry standard for hotel refurbishment is a 25-year cycle. The review concluded that AFRC-O would generate more than sufficient funds for this purpose.

Page 22 **Major Renovations at AFRC-O, page 16 of the Draft Audit Report:**

The DoDIG report contends that current and programed maintenance and repair budgets are inadequate to maintain Disney standards. They base their contention on the General Services Administration (GSA) estimate that a hotel building, because it is fully depreciated in 37 years, must be replaced. The GSA 37-year useful life estimate relates to a building value baseline for accounting and tax purposes. Many hotels (the Willard, the New York Plaza, the Pierre Hotel, the Maryland Inn) are well over 37-years old.

The DoDIG's methodology, which ties depreciation to useful life of a building, is incorrect and should be deleted from the final report.

Ability to fund renovations is addressed above.

Page 23 **Hotel Industry Standard for Maintenance, page 16 of the Draft Audit Report:**

The DoDIG contention the AFRC-O will have insufficient funds for long-term maintenance and rebuilding costs is unfounded.

An independent assessment of repair and maintenance and capital investments requirements conducted by Pannell Kerr Forster Consulting, Inc., concludes:

- Since opening in February 1994 AFRC-O has been spending and continues to budget for annual repair and maintenance expenses of $3,316 per guestroom.
- There are two authoritative sources for obtaining hospitality industry averages

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August 29, 1995

for such expenses:

Trends in the Hotel Industry, U.S. Edition, published by Pannell Kerr Forster Consulting, Inc. which has monitored those expenses for 1,000 hotels for the past 21 years. This study indicates that annual repair and maintenance costs are $1,688 per guestroom.

The International Association of Hospitality Consultants which has monitored such expenses for 196 well-maintained hotels for the past 11 years. This study indicates that annual repair and maintenance costs are $1,854 per guestroom.

- AFRC-O capital investment costs are substantially higher than industry averages partially due to the Army's requirement to maintain Disney standards and the Army's commitment to maintain a superior facility. At 29 acres, AFRC-O has more landscaped grounds to maintain than most hotels. Excluding those landscaping costs, AFRC-O would be spending $2,542 annually per guestroom. This amount is not excessive considering AFRC-O's current superior condition and is adequate to maintain Disney, Army, and hospitality industry standards.

- Hotels are generally maintained in a 25-year cycle. During that cycle all systems and equipment are expected to be repaired or replaced. Some Items, such as carpets and furnishings, would be replaced several times during that cycle. The most authoritative study of industry averages was compiled by The International Society of Hospitality Consultants. Their study developed future capital investment models for 100-guestroom limited-service hotels, 200-guestroom moderately priced full-service hotels, and 300-guestroom upscale full-service hotels.

- AFRC-O most closely approximates the 300-guestroom upscale requirement, which is the most expensive.

- Over a 25-year period AFRC-O can maintain its superior condition and avoid a massive un-programmed capital expense by making capital investments of $72,483 per guestroom for a total cost of $20.8 million (1995 value dollars). This figure of $20.8 million over 25 years is the real projected requirement versus the $75 million figure suggested by the DoDIG at year 2020.

- Over 25 years AFRC-O can be expected to generate $65.8 million positive cash flow, after funding annual repair and maintenance costs of $22.2 million of annual operating costs.

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page 22

Major Renovations at AFRC-Orlando, page 16 of the Draft Audit Report:

The DoDIG is working under the assumption that AFRC-O will require demolition and total rebuild in approximately 30 years. GSA's estimate may be valid for accounting purposes, it does not mean that a properly maintained building will require demolition or total rebuild in 37 years. Properly maintained and periodically refurbished hotels have a useful life in excess of 100 years. The DoDIG's estimated $261,000 per-guestroom capital investment cost is overstated and is not substantiated in the hospitality industry.

DoDIG Recommendation C-1. We recommend that, contingent upon the approval to purchase AFRC-O, the Commander, USACFSC:

Develop a long-range maintenance plan, including phased renovation for refurbishment and rebuilding AFRC-O.

Army Response: Concur.

DoDIG Recommendation C-2: Finance the maintenance plan using AFRC-O-generated cash flow.

Army Response: Concur.

C-2. AFRC-O will generate adequate cash for repairs and maintenance in full compliance with Disney standards using annual operating expenses. The letter at Annex D from the President of Palm Hospitality Company confirms that the Army is in full compliance with repair and maintenance requirements. The HCMF will fund the capital expenditures as it does for all other AFRCs. Over the next 25 years AFRC-O will have contributed more than sufficient cash to the HCMF to have fully complied with this recommendation.

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Walt Disney World Co.

Al Weiss
Executive Vice President
Walt Disney World

August 29, 1995

Mr. Peter Issacs
Director of Hospitality
U.S. Army Community & Family
Support Center
2760 Eisenhower Avenue, Suite #400
Alexandria, Virginia 22314

Dear Mr. Issacs:

This is to follow up on our recent conversations regarding referral of overflow hotel guests by Shades of Green to Walt Disney World Co. and other non-Disney hotels in the Orlando metropolitan area.

As you know, whenever Shades of Green has no vacancies for guests who would otherwise be entitled to stay at that facility, it has requested Walt Disney World Co., and other non-Disney hotels, to provide rooms for the overflow guests. Thus far, we have been able to accommodate some of these overflow guests on a discounted rate, space available basis. However, as I have explained, the demand for our rooms continues to grow. Indeed, it is our policy to build to demand and we continue to do so with over 2,340 hotels rooms under construction and more rooms scheduled to begin construction during the foreseeable future. In short, we cannot give you any assurance that rooms will be available at any particular time when you have overflow needs, nor can we guarantee any types of discounted rates, since as you know, we run very high occupancy rates, particularly at the low end of our hotel product range. Furthermore, even the lower end of our hotel product range cannot meet at the bargain rates Shades of Green was designed to provide to the enlisted service people.

Frank, Dan and I very much enjoyed meeting with you and the federal officials at Shades of Green on August 22, 1995.

If we can be of any further assistance, please do not hesitate to let us know.

Very truly yours,

Al Weiss

Al Weiss

P.O. Box 10,000 / Lake Buena Vista, Florida 32830-1000

A Division of The Walt Disney Company.

Aug. 29. 1995 12:04PM No. 4881 P. 2/2

Occupancy = 98%

OPERATING FORECASTS, FY 96 - FY 99 (000's)

	FY 96	FY 97	FY 98	FY 99
Occupancy Rate	98%	98%	98%	98%
Average Daily Rate	$ 77.48	$ 80.58	$ 83.80	$ 87.15
REVENUES:				
Rooms	$ 7,976	$ 8,272	$ 8,603	$ 8,947
Food & Beverage	$ 2,524	$ 2,625	$ 2,730	$ 2,839
Telephone	$ 47	$ 49	$ 51	$ 53
Attraction Ticket Concession Income	$ 703	$ 732	$ 761	$ 791
Other	$ 712	$ 741	$ 770	$ 801
Total Revenue	$ 11,963	$ 12,419	$ 12,915	$ 13,432
EXPENSES:				
Direct Operating Departments	$ 5,218	$ 5,418	$ 5,635	$ 5,860
Undistributed Departments	$ 2,721	$ 2,830	$ 2,943	$ 3,060
Property Operations & Maintenance	$ 923	$ 959	$ 998	$ 1,038
Insurance	$ 126	$ 131	$ 136	$ 142
Capital Reinvestment Assessment (1)	$ 239	$ 373	$ 387	$ 403
Building/Land Rent	$ -	$ -	$ -	$ -
Total Cash Expenses	$ 9,227	$ 9,710	$ 10,099	$ 10,503
NET CASH PRODUCED FROM OPERATIONS	$ 2,736	$ 2,708	$ 2,817	$ 2,929
Amortization, Pre-opening (2)	$ 313	$ 104	$ -	$ -
Amortization, Prepaid Land Rent (3)	$ *	$ *	$ *	$ *
Depreciation (4)	$ 1,367	$ 1,433	$ 1,517	$ 1,558
Total Non-cash Expenses	$ *	$ *	$ *	$ *
NET INCOME	$ *	$ *	$ *	$ *

(1) Capital Reinvestment Assessment (2% in FY 96; 3% thereafter) paid to the Army MWR Fund

(2) Pre-opening expenses of $850K amortized over three years.

(3) Prepaid land rent of $ * amortized over 100 years (life of lease).

(4) Depreciation includes $30 million purchase price depreciated over 30 years.

SOURCE: Shades of Green for FY 96 Projections;
FY 97 - FY 99 Estimates are Adjusted for Inflation.

8/29/95 12:01 PM

*Proprietary data deleted.

At Varying Occupancies to to Determine Break-even Occupancy Percentage

OPERATING FORECASTS, Break-even Point Analysis (000's)

Occupancy Rate	98%	96%	94%	92%	90%	85%	80%	75%	73.79%
Average Daily Rate	$ 77.48	$ 77.48	$ 77.48	$ 77.48	$ 77.48	$ 77.48	$ 77.48	$ 77.48	$ 77.48
REVENUES:									
Rooms	$ 7,976	$ 7,813	$ 7,650	$ 7,488	$ 7,325	$ 6,918	$ 6,511	$ 6,104	$ 6,006
Food & Beverage	$ 2,524	$ 2,473	$ 2,421	$ 2,370	$ 2,318	$ 2,189	$ 2,060	$ 1,932	$ 1,901
Telephone	$ 47	$ 46	$ 45	$ 44	$ 43	$ 41	$ 38	$ 36	$ 35
Attraction Ticket Concession Income	$ 703	$ 689	$ 675	$ 660	$ 646	$ 610	$ 574	$ 538	$ 530
Other	$ 712	$ 668	$ 624	$ 550	$ 448	$ 332	$ 313	$ 293	$ 288
Total Revenue	$ 11,963	$ 11,689	$ 11,415	$ 11,112	$ 10,780	$ 10,090	$ 9,497	$ 8,903	$ 8,760
EXPENSES:									
Direct Operating Departments	$ 5,218	$ 5,166	$ 5,115	$ 5,063	$ 5,013	$ 4,963	$ 4,913	$ 4,864	$ 4,815
Undistributed Departments	$ 2,721	$ 2,721	$ 2,721	$ 2,721	$ 2,721	$ 2,721	$ 2,721	$ 2,721	$ 2,721
Property Operations & Maintenance	$ 923	$ 923	$ 923	$ 923	$ 923	$ 923	$ 923	$ 923	$ 923
Insurance	$ 126	$ 126	$ 126	$ 126	$ 126	$ 126	$ 126	$ 126	$ 126
Capital Reinvestment Assessment (1)	$ 239	$ 234	$ 228	$ 222	$ 216	$ 202	$ 190	$ 178	$ 175
Building/Land Rent	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Cash Expenses	$ 9,227	$ 9,169	$ 9,112	$ 9,055	$ 8,998	$ 8,934	$ 8,872	$ 8,811	$ 8,760
NET CASH PRODUCED FROM OPERATIONS	$ 2,736	$ 2,519	$ 2,303	$ 2,057	$ 1,782	$ 1,157	$ 625	$ 92	$ 0
Amortization, Pre-opening (2)	$ 313	$ 313	$ 313	$ 313	$ 313	$ 313	$ 313	$ 313	$ 313
Amortization, Prepaid Land Rent (3)	$ *	$ *	$ *	$ *	$ *	$ *	$ *	$ *	$ *
Depreciation (4)	$ 1,367	$ 1,367	$ 1,367	$ 1,367	$ 1,367	$ 1,367	$ 1,367	$ 1,367	$ 1,367
Total Non-cash Expenses	$ *	$ *	$ *	$ *	$ *	$ *	$ *	$ *	$ *
NET INCOME	$ *	$ *	$ *	$ *	$ *	$ *	$ *	$ *	$ *

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*Proprietary data deleted.

At Varying Occupancies to to Determine Break-even Occupancy Percentage

OPERATING FORECASTS,
FY 96 - FY 99
(000's)

	FY 96	FY 97	FY 98	FY 99
Occupancy Rate	98%	98%	98%	98%
Average Daily Rate	$ 77.45	$ 80.58	$ 83.80	$ 87.15
REVENUES:				
Rooms	$ 7,976	$ 8,272	$ 8,603	$ 8,947
Food & Beverage	$ 2,524	$ 2,625	$ 2,730	$ 2,839
Telephone	$ 47	$ 49	$ 51	$ 53
Attraction Ticket Concession Income	$ 703	$ 732	$ 761	$ 791
Other	$ 712	$ 741	$ 770	$ 801
Total Revenue	$ 11,963	$ 12,419	$ 12,915	$ 13,432
EXPENSES:				
Direct Operating Departments	$ 5,218	$ 5,418	$ 5,635	$ 5,860
Undistributed Departments	$ 2,721	$ 2,830	$ 2,943	$ 3,060
Property Operations & Maintenance	$ 923	$ 959	$ 998	$ 1,038
Insurance	$ 126	$ 131	$ 136	$ 142
Capital Reinvestment Assessment (1)	$ 239	$ 373	$ 387	$ 403
Building/Land Rent	$ -	$ -	$ -	$ -
Total Cash Expenses	$ 9,227	$ 9,710	$ 10,099	$ 10,503
NET CASH PRODUCED FROM OPERATIONS	$ 2,736	$ 2,708	$ 2,817	$ 2,929
Amortization, Pre-opening (2)	$ 313	$ 104	$ -	$ -
Amortization, Prepaid Land Rent (3)	$ *	$ *	$ *	$ *
Depreciation (4)	$ 1,367	$ 1,433	$ 1,517	$ 1,558
Total Non-cash Expenses	$ *	$ *	$ *	$ *
NET INCOME	$ *	$ *	$ *	$ *

(1) Capital Reinvestment Assessment (2% in FY 96; 3% thereafter) paid to the Army MWR Fund

(2) Pre-opening expenses of $850K amortized over three years.

(3) Prepaid land rent of $ * amortized over 100 years (life of lease).

(4) Depreciation includes $30 million purchase price depreciated over 30 years.

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*Proprietary data deleted.

PALM HOSPITALITY COMPANY
POST OFFICE BOX 22825
LAKE BUENA VISTA, FLORIDA 32830
PHONE (407) 824-1474 FAX (407) 824-0038

August 15, 1995

Peter F. Isaacs
Director, Hospitality
2760 Eisenhower Avenue
Suite 400
Alexandria, Virginia 22314

Re: Shades of Green™ on WALT DISNEY WORLD® Resort ("Hotel") --
Lease Agreement dated November 3, 1993 (the "Lease")

Dear Mr. Isaacs:

In response to your request, this is to confirm that, as President of Palm Hospitality Company ("Palm") during the prior 12 months, I have conducted periodic reviews of the maintenance, alterations, and improvements associated with buildings, fixtures, and grounds of the Hotel.

Based upon my reviews of the Hotel and to the best of my knowledge, I am of the opinion that the U.S. Army Morale, Welfare, and Recreation Fund is in compliance with the terms of the Lease regarding maintenance and operating standards.

I look forward to our continuing business relationship.

Yours sincerely,

Dan Darrow
President

Audit Team Members

This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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